Supreme Court, U.S.
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No. ____

In The

Supreme Court of the United States

CHOICE HOTELS INTERNATIONAL, INC.,

Petitioner,

v.

JAMES L. TICKNOR; JANET TICKNOR; LARRY TICKNOR; TICKCO HOLDING, L.L.C.; AND TICKNOR LODGING CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether a court may refuse to enforce, on unconscionability grounds due to lack of mutuality or inadequate consideration, an arbitration agreement in a contract to which the Federal Arbitration Act (9 U.S.C. § 1 et seq.) applies based upon a state court decision applicable to arbitration agreements but not applicable to all contracts under state law, and applicable to consumer contracts of adhesion but not yet extended to sophisticated business parties by that state court.

2. Whether the existence of mutual promises by parties to a contract to arbitrate at least some claims precludes a finding that a contract to which the Federal Arbitration Act is applicable is unenforceable due to unconscionability resulting from lack of mutuality or inadequate consideration, particularly where the state law to be applied by a federal court sitting in diversity requires construction of contractual obligations in such a way as to make the obligations imposed mutually binding.

3. Whether a court may base its refusal to honor a choice of law provision in a contract upon a state law policy that invalidates arbitration agreements due to a state policy regarding unconscionability for lack of mutuality or inadequacy of consideration in a state where other contracts are not invalidated for those reasons.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, petitioner Choice Hotels International, Inc. states that it has no parent companies or subsidiaries, and that no publicly held company owns 10% or more of its stock.

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PETITION FOR A WRIT OF CERTIORARI

Choice Hotels International, Inc. respectfully petitions this Honorable Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit (App., *infra*, 1a-22a) is reported at 265 F.3d 931. The district court opinion (App., *infra*, 23a-34a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on September 12, 2001. That order is appealable pursuant to the Federal Arbitration Act, 9 U.S.C. § 16, which provides that an appeal may be taken from an order refusing a stay of any action under section 3 of that title. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of the Constitution of the United States provides, in pertinent part, that "the Laws of the United States . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any

State to the Contrary notwithstanding." U.S. CONST. art. VI, cl. 2.

The relevant sections of the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* ("FAA"), are reproduced at App., *infra*, 35a-38a.

STATEMENT OF THE CASE

This case presents questions of broad importance and issues having far-reaching implications for arbitration agreements in contracts involving interstate commerce, as well as the ability of parties to enforce them throughout the United States on a uniform basis and unfettered by state judicial rulings rendering them unenforceable, contrary to the express language and clear intent of both the Federal Arbitration Act ("FAA") and the rulings of this Court. In upholding the order of the district court denying a motion by Choice Hotels International, Inc. ("Choice") to compel arbitration of an action brought in connection with a contract containing an arbitration agreement, the Ninth Circuit has effectively endorsed the efforts of a state court that would impose strictures upon agreements to arbitrate and has granted to the courts of that State the prerogative to judicially review the adequacy of consideration in arbitration contracts and dictate the terms upon which parties may arbitrate, a function they may not exercise under state law with respect to contracts generally.

A. STATUTORY BACKGROUND

The Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, provides that written agreements to arbitrate disputes arising out of transactions involving interstate commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The FAA "reverses centuries of judicial hostility to arbitration agreements" [*Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510 (1974)] and permits "parties to an arbitrable dispute [to move] out of court and into arbitration as quickly and as easily as possible." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 22 (1983):

> The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a defense to arbitrability.

Id., 460 U.S. at 24-25.

A court is empowered to stay an action and compel arbitration pursuant to the explicit provisions of Sections 2, 3 and 4 of the FAA:

> Section 2 provides that a written provision for arbitration "in any maritime transaction or a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." Section 3 requires a federal court in which suit has been brought "upon any issue

> referable to arbitration under an agreement in writing for such arbitration" to stay the court action pending arbitration once it is satisfied that the issue is arbitrable under the agreement. Section 4 provides a federal remedy for a party "aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration," and directs the federal court to order arbitration once it is satisfied that an agreement for an arbitration has been made and has not been honored.

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 400 (1967).

B. FACTUAL AND PROCEDURAL BACKGROUND

On or about March 10, 1998, Ticknor Lodging Corporation, a South Dakota corporation, and James L. Ticknor entered into a franchise agreement with Choice, a Maryland franchisor of hotel brands, pursuant to which they were granted a license to operate a hotel located in Bozeman, Montana under the Econo Lodge® marks of Choice in exchange for the payment of certain fees. App., *infra*, 23a-24a. On the same date, Janet Ticknor, Larry Ticknor and Tickco Holding, L.L.C. entered into a contract with Choice in which they agreed to guaranty the performance of Ticknor Lodging and James L. Ticknor throughout the term of their franchise agreement with Choice, including each and every covenant, payment or obligation contained therein.[1] *Id.*

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[1] With Ticknor Lodging Corporation and James L. Ticknor, the guarantors are referred to herein collectively as "the Ticknors" or "respondents."

The franchise agreement contained two addenda amending its terms which, *inter alia*, reduced the liability of the Ticknors for liquidated damages in the event of their termination under the terms of the franchise agreement. App., *infra*, 32a.

The franchise agreement contained an arbitration clause which provides as follows:[2]

> Except for our claims against you for indemnification, actions for collection of moneys owed us under this Agreement, or actions seeking to enjoin you from using the Marks in violation of this Agreement, any controversy or claim relating to this Agreement, or the breach of this Agreement, including any claim that this Agreement or any part of this Agreement is invalid, illegal, or otherwise voidable or void, will be sent to final and binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitrator will apply the substantive laws of Maryland, without reference to its conflict of laws provision. Judgment on the arbitration award may be entered in any court having jurisdiction. If any party fails to appear at any properly noticed arbitration proceeding, an award may be entered against the party, notwithstanding its failure to appear. Any arbitration will be conducted at our headquarters office in Maryland.

App., *infra*, 29a-30a. The franchise agreement also contained a choice of law provision which provided that

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[2] Throughout the contract, "we" and "our" refer to Choice, while "you" refers to respondents.

"[t]his Agreement becomes valid only when we have signed it, and it will be interpreted under the substantive laws of Maryland, not including its conflict of laws provision." *Id.*

On March 23, 1999, Choice forwarded a notice of termination of the franchise agreement to James L. Ticknor and Ticknor Lodging Corporation in which Choice notified them and the guarantors that the franchise agreement was terminated, effective immediately, due to unremedied material defaults in the performance of their duties under the Agreement, specifically, their failure to pay outstanding franchise and related fees pursuant to the terms of the agreement. App., *infra*, 23a-24a. On or about July 8, 1999, Choice filed a demand for arbitration against the Ticknors with the American Arbitration Association seeking payment of past franchise fees and damages for profits lost due to the premature termination of the franchise agreement. *Id.*

Instead of responding to the arbitration proceedings, the Ticknors on August 9, 1999 filed a complaint against Choice in the Montana state court for rescission, breach of contract, negligent misrepresentation, and fraud in connection with the franchise agreement (App., *infra.*, 31a), along with a motion to enjoin the arbitration proceeding, which was granted *ex parte* by the state court judge on the same date. App., *infra.*, 24a. Choice then removed the action to the United States District Court for the District of Montana, Butte Division, and filed a motion pursuant to the Federal Arbitration Act to dismiss the action or, in the alternative, to stay it and compel its arbitration. App., *infra.*, 24a-25a. The basis for the jurisdiction of the district

court was diversity of citizenship pursuant to 28 U.S.C. § 1332 and the removal provisions of 28 U.S.C. § 1441.

The district court denied the motion of respondents for a temporary restraining order on September 9, 1999 and scheduled a hearing on their motion for a preliminary injunction. App., *infra*, 25a. At the September 15, 1999 oral argument on the motion for preliminary injunction, Choice agreed to delay the arbitration proceedings until after the pending motions could be heard. *Id.* Choice withdrew the demand for arbitration it had previously filed with the American Arbitration Association on October 9, 1999, and filed a notice of the withdrawal of the arbitration with the district court on October 18, 1999. *Id.*

C. PROCEEDINGS IN THE DISTRICT COURT

On December 6, 1999, the district court entered an order denying the motion of Choice to dismiss or stay the action and to compel arbitration of respondents' claims. App., *infra*, 23a-34a. The lower court first held that a clause specifying that Maryland law should be applied to the resolution of disputes between the parties would not be enforced because, under state conflict of laws provisions, the choice of law provision would be "contrary to a fundamental policy of a state (Montana) which has a materially greater interest than the chosen state in the determination of the particular issue and which . . . would be the state of the applicable law in the absence of an effective choice of law by the parties." App., *infra*, 26a. In support of this finding, the district court evaluated the five factors enumerated in Restatement (Second) of Conflict of Laws § 188 to be used in determining the state

which has a materially greater interest in an issue, finding with respect to the "place of contracting" that the contract was signed both in Montana and Maryland (App., *infra*, 27a), a finding the Ninth Circuit would later characterize as inaccurate due to fact that the contract was actually executed by James Ticknor in Mexico at a time when he was a Colorado resident (App., *infra*, 8a-9a); that negotiations took place in Montana (App., *infra*, 27a), despite the district court's concurrent and inconsistent finding that the contract was one of adhesion as to which there had been no opportunity to negotiate (App., *infra*, 32a); that the "place of performance" and the "subject matter" of the contract were "rooted in Montana" because respondents' hotel was located in Montana (App., *infra*, 27a), despite the district court's acknowledgment that the Ticknors mailed their franchise and related fees to Maryland and that the franchise agreement required Choice to provide the Ticknors with a license to use the Econo Lodge® trademarks, access to Choice's reservation system, and the benefits of national advertising (App., *infra*, 24a, 27a); and that respondents were located in Montana (App., *infra*, 27a), another finding the Ninth Circuit found to be inaccurate due to the fact that Larry and Janet Ticknor were located in South Dakota, not Montana (App., *infra*, 8a-9a).

Having concluded that Montana had a greater material interest in the agreement, and that the law of Montana would govern the dispute absent a choice by the parties of the law of another state, the trial court went on to find that the "determination of unconscionability issues under another state's law would be contrary to Montana's fundamental policy of protecting its citizens

from agreements that are contrary to Montana's fundamental policies" and that "[a]pplying Maryland law to determine this issue would be unconscionable." App., *infra*, 27a-28a.

In determining whether or not the arbitration clause in the contract between Choice and respondents was unconscionable under Montana law, the district court cited to and considered a single Montana case, *Iwen v. U.S. West Direct*, 293 Mont. 512, 977 P.2d 989 (1999), which involved an agreement to arbitrate printed on the back of an order form for local telephone directory advertising ordered by a consumer, and held that the arbitration clause in the contract between Choice and respondents was unconscionable because Choice reserved "the right of access to the courts and to juries for itself alone," adding that Choice could not enforce the clause against the Ticknors regardless of whether "it lacks consideration under Maryland law or is unconscionable under Montana law"[3] (App., *infra*, 33a) and denied Choice's arbitration motion.

D. PROCEEDINGS IN THE NINTH CIRCUIT

A divided panel of the Ninth Circuit, over a dissent by Judge Tashima, affirmed the district court. Although it

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[3] Although the district court also mentioned the fact that "Choice required its franchisees to travel to Maryland, a hardship that a court of law could not impose because of due process requirements for personal jurisdiction," this ground was not mentioned by the Ninth Circuit in its own opinion and would clearly constitute an erroneous finding in any event under *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

found the lower court's findings with respect to two of the five factors to be erroneous,[4] the court of appeals agreed with the conclusion of the former that "Montana has a materially greater interest than Maryland in the transaction," concurring with the finding of the trial court that "the purpose of the contract was to establish and govern operation of a motel franchise in Montana," and adding several factors not set forth in Restatement (Second) of Conflict of Laws § 188 but which are often seen in the context of an analysis of contacts for the purpose of determining whether a federal court may exercise personal jurisdiction over a party, including the facts that "the only face-to-face meeting between Choice representatives and James Ticknor occurred in Montana," "James Ticknor never traveled to Maryland," and "Maryland provided an address for depositing payments, but little else." App., *infra*, 9a.

Instead of at that juncture determining whether or not Maryland law would conflict with that of Montana regarding the enforceability of contract provisions being challenged on unconscionability grounds, the court of appeals found that, if Maryland law differed from that of

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[4] Based upon these statements by the court of appeals regarding the inaccuracy of certain of the factual findings of the district court, it is clear that, of the five factors used to evaluate the materiality of state interests for purposes of determining choice of law in the absence of a choice of law provision, two of them (place of contracting and place of domicile) favor Choice; one of them (place of negotiation) is inapplicable; and two of them (place of performance and location of subject matter) have elements related to both Maryland and Montana.

Montana, then Montana law would apply because Montana public policy requires the application of the decision of the Montana Supreme Court barring enforcement of "an arbitration clause that 'lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter' " (citing *Iwen, supra,* at 977 P.2d 996). App., *infra,* 10a. The court of appeals made this finding on the basis of *Iwen* and in the absence of any Montana state law extending the principles set forth in that case from the consumer context to commercial contracts between sophisticated parties.

Having concluded that *Iwen* was applicable and that it would also be applicable in the context of sophisticated business owners, the panel majority found that the arbitration provision in the contract between Choice and respondents was a contract of adhesion that "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter." App., *infra,* 14a. It went on to state that the decision in *Iwen* was not preempted by the Federal Arbitration Act because "Montana law pertaining to the unconscionability of arbitration clauses (is) the result of the 'application of general principles that exist at law or in equity for the revocation of any contract.' " *Iwen, id.* In affirming the lower court's ruling, the panel went on to reconsider and overrule the prior Ninth Circuit decisions in *Cohen v. Wedbush, Noble, Cooke, Inc.,* 841 F.2d 282 (1988), and *Bayma v. Smith Barney, Harris Upham and Co.,* 784 F.2d 1023 (9th Cir. 1986) to the extent that those cases held that "state law adhesion principles may not be invoked to bar arbitrability of disputes under the Arbitration Act." App., *infra,* 16a.

In his dissenting opinion, Judge Tashima stated that, in his view, the arbitration contract was neither a contract of adhesion nor so one-sided as to make it unconscionable, that Maryland law should be applied to the case, and that the decision of the lower court should be reversed. Judge Tashima collected and described those Montana cases relating to contracts of adhesion, pointing out that Montana had "used the adhesion doctrine to protect unsophisticated consumers in *consumer* transactions with no meaningful choice," and that the "rule of adhesion has never been applied to commercial contracts between sophisticated business organizations." (Emphasis in original). App., *infra*, 18a. Judge Tashima also pointed out that the Ticknors were not unsophisticated consumers, nor had they shown they had no other viable alternatives to entering into the contract, or that they, for example, faced the possibility of being excluded from the hotel franchise market unless they accepted a contract with such an agreement to arbitrate, facts in direct contrast with those in *Iwen*. App., *infra*, 19a-20a.

With regard to the terms of the arbitration clause, itself, Judge Tashima pointed out that, "should either party wish to proceed against the other for almost any obligation *under the contract*, that party must do so through arbitration (emphasis in original)," pointing out that, by contrast, the consumer contract in *Iwen* contained a single remedy for both parties, i.e., the cost of the advertisement, but that the telephone company could enforce that remedy in court, while the consumer was limited to pursuit in arbitration. App., *infra*, 20a-21a.

Judge Tashima also pointed out the distinction previously noted by the Ninth Circuit between "procedural

unconscionability (related to the manner and circumstances of contract formation, i.e., was it truly a contract of adhesion), and substantive unconscionability (which analyzes the terms of the agreement, i.e., is so one-sided as to *shock the conscience*) (emphasis in original)," and suggested that the panel should have proceeded using the same analysis, under which the agreement between Choice and respondents was "clearly not an unenforceable adhesion contract." App., *infra*, 22a.

Finally, Judge Tashima stated the view that, because the arbitration clause does not violate Montana law, the parties' choice of law should have been enforced and Maryland law, which would treat the mutual promises to arbitrate as an independently enforceable contract, should have been applied by the lower court.

REASONS FOR GRANTING THE WRIT

The decision of the Ninth Circuit has expanded considerably the grounds upon which a federal court sitting in diversity may invalidate agreements to arbitrate that are subject to the FAA based upon a prediction that the State of Montana would extend the law relating to adhesion contracts and unconscionability principles from consumer transactions to those involving sophisticated business parties, as opposed to state law principles that currently exist. In doing so, it has also set a precedent that would permit courts to examine the adequacy of consideration in all agreements to arbitrate that contain mutual, though not always identical, obligations to arbitrate, even those that do not "shock the conscience."

The decision of the Ninth Circuit is also in direct conflict with the FAA and decisions of this Court, which require that agreements to arbitrate as to which the FAA is applicable be valid, irrevocable, and enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract," including the ruling in *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), as the state law decision relied upon by the court of appeals was applicable only to arbitration clauses, and not to all contracts generally.

Finally, the decision of the Ninth Circuit conflicts with decisions upholding similar arbitration agreements against challenges based upon lack of mutuality, lack of consideration and unconscionability in the Second Circuit, Third Circuit, Fourth Circuit, Seventh Circuit and Eighth Circuit. Only this Court can properly clarify further the boundaries upon the power of the district courts and state courts to apply state law principles to render unenforceable arbitration agreements in contracts subject to the FAA, and it is likely that the already abundant litigation on these issues will continue absent such clarification.

I. THE DECISION OF THE NINTH CIRCUIT CONFLICTS WITH THE CLEAR LANGUAGE OF THE FAA AND WITH THIS COURT'S DECISIONS IN *ERIE* AND *KLAXON*

Section 2 of the FAA provides for the revocation of arbitration agreements only upon "such grounds as *exist* at law or in equity for the revocation of any contract." (Emphasis supplied.) The law does not, by its terms,

grant courts the right to revoke arbitration agreements based upon speculation or predictions as to what the law may be at some point in the future or based upon such grounds for revocation as at one time may have existed but which are no longer recognized, nor do any decisions of this Court provide an interpretation of the FAA that would support such a proposition.

Except in matters governed by the Constitution or by acts of Congress, a federal court sitting in diversity must apply the law of the state in which it sits. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938). This Court has also stated that the proper function of a federal court employing a conflict of laws analysis "is to ascertain what the state law is, not what it ought to be." *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 497 (1941).

Both the district court and the Ninth Circuit in the instant case ignored the basic principles of *Erie* and *Klaxon*. From its reading of the Montana Supreme Court decision in *Iwen*, the district court divined a broad policy in the State of Montana declaring the arbitration clauses in form contracts used in transactions between experienced business parties to be contracts of adhesion and, if the rights or obligations of the parties to the agreements differed, unenforceable as unconscionable. This reading, however, ignored the facts of *Iwen*, which involved an arbitration clause set forth on the back of a purchase order form for a telephone directory advertisement submitted by a consumer to the directory company, not sophisticated business entities entering into a long-term relationship involving substantial obligations. It also ignored the fact that Montana case law prior to that

decision had not expressed a such a policy; to the contrary, at least one prior Montana holding was to the effect that "[a]lthough courts have readily applied the doctrine of unconscionability to contracts between consumers and skilled businessmen, they are reluctant to rewrite the terms of a contract between businessmen themselves." *All-States Leasing Company v. Top Hat Lounge, Inc.*, 198 Mont. 1, 6, 649 P.2d 1250, 1253 (1982).

The Ninth Circuit also elected to extend the holding of *Iwen* to contracts between skilled businesspersons. In doing so, it cited *In re Michael*, 264 Mont. 261, 266, 871 P.2d 272, 275 (1994), for the proposition that "[o]ppression and a disparity of bargaining power are the indicia of unconscionability relating to a sales contract between two business professionals," without pointing out that the court in that case concluded that there was no unconscionability evident from the difference between purchase price and market price of an item, and that such a consideration would not be material to such a determination.

Even though it was improper for the Ninth Circuit to apply Montana law to the disputes in question in the first instance, even if that course of action were appropriate, it is plain that the district court could not have discharged its obligation to apply the law of Montana as it existed if it failed to observe established state law principles relating to the interpretation of contracts. Under Montana law, a "contract should be construed in such a way as to make the obligations imposed by its terms mutually binding upon the parties, unless such construction is wholly negatived by the language used." *Wandell v. Johnson*, 71 Mont. 73, 227 P. 58, 60 (1924). *Cf. Choice Hotels International, Inc. v. BSR Tropicana Resort, Inc.*, 252 F.2d 707 (4th

Cir. 2001) (holding that an arbitration clause identical to that in the instant case required Choice to arbitrate its claims for breach of contract, while claims for collection of moneys owed were excepted from the scope of the clause). Instead of acknowledging this principle of Montana law and applying it in this case, the Ninth Circuit ignored it and instead relied upon inapplicable precedents relating to an unconscionability principle which the Supreme Court of Montana had not yet definitively applied to transactions between sophisticated business parties. Accordingly, the Ninth Circuit violated its obligations under *Erie*, and its failure to apply Montana law constituted error.

In light of the foregoing status of Montana law, the Ninth Circuit could not, without doing violence to the principles set forth in *Erie* and *Klaxon*, find Montana law to be as it found it. While it is plain that Montana law has not extended the holding of *Iwen* to other cases, even if it could be found that some decisions supported such a reading, the fact that other decisions clearly conflicted with the interpretation of those cases by the court of appeals should have prevented it from speculating as to which line of cases Montana courts would ultimately adopt, and its speculation in that regard was erroneous.

II. THE DECISION OF THE NINTH CIRCUIT CONFLICTS WITH THIS COURT'S DECISION IN *CASAROTTO*

This Court has stated that "the text of § 2 (of the FAA) declares that state law may be applied *'if* that law arose to govern issues concerning the validity,

revocability, and enforceability of contracts generally (emphasis in original).' " *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 686-687 (1996), citing *Perry v. Thomas*, 482 U.S. 483, 492, n.9 (1987). "Courts may not, however, invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." *Casarotto*, 517 U.S. at 687. It has further been made clear that "a court may not 'rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect . . . what the state legislature cannot.' " *Id.* at 687 n.3. To the extent that such a state decision or legislative requirement is inconsonant with the FAA and its purpose of "ensuring that private agreements to arbitrate are enforced according to their terms," *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989), it is preempted by that federal law. *Casarotto*, 517 U.S. at 688.

In passing upon the arbitration agreement in the contract between Choice and respondents, the Ninth Circuit found it to be unenforceable because it "allowed Choice to bring its claims against Ticknor into state or federal court, yet forced (respondents) to submit all claims to binding arbitration" and that, as a result, it lacked " 'mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter.' " App., *infra*, 14a, citing *Iwen*, 977 P.2d at 996. Even a cursory review of Montana cases on the ability of courts to inquire into the adequacy of consideration reveals, however, that such a law is not applied to Montana contracts generally. Montana recognizes the "rule . . . that inadequacy of consideration, standing

alone, is not a sufficient ground for refusing to enforce an agreement." *Hodgkiss v. Northland Petroleum Consol*, 104 Mont. 328, 67 P.2d 811, 814 (1937); *Pederson v. Thoeny*, 88 Mont. 569, 295 P. 250, 252 (1930).

Similarly, Montana courts do not examine the nature of promises to assure that they are identical, mirror images of each other, and have held that a "contract should be construed in such a way as to make the obligations imposed by its terms mutually binding upon the parties, unless such construction is wholly negatived by the language used." *Wandell v. Johnson*, 71 Mont. 73, 227 P. 58, 60 (1924). Further, "mutual promises alone are enough to constitute valid consideration" under Montana law (*Miller v. Titeca*, 192 Mont. 357, 364-365, 628 P.2d 670, 675 (1981), *citing* Mont. Code Ann. § 28-2-801), and "relinquishment of a legal or contract right is sufficient consideration to support a contract." *Rudio v. Yellowstone Merchandising Corp.*, 200 Mont. 537, 544, 652 P.2d 1163, 1167 (1982).

Further evidence of the fact that the principles of *Iwen* have been applied only to arbitration agreements and not to other contracts under Montana law is found in *State ex rel. Mountain States Telephone and Telegraph Company v. District Court of the Second Judicial District in and for the County of Silver Bow*, 160 Mont. 443, 503 P.2d 526 (1972). In that case, suit was brought by two business customers of a telephone company for damages due to the failure of the latter to list them in a directory, despite their written order requesting one. The Montana Supreme Court directed the lower court to enter summary judgment in favor of the utility based upon a limitation of

liability provision contained in the General Exchange Tariff of the company, despite arguments by the plaintiffs that the provision was unconscionable. The court stated that the "mere fact of claimed unequal bargaining position does not render it" unconscionable, and further noted that a "[l]imitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not." 503 P.2d at 531 (*citing* 87A-2-719, R.C.M. 1947). The only salient difference between this case and *Iwen* is the fact that *Iwen* related to an arbitration clause and *Mountain States* did not.

For the same reasons, the Ninth Circuit could not, without running afoul of the principles set out in *Casarotto* and *Perry*, employ a choice of law and conflicts of law analysis that would have the effect of invalidating the arbitration agreement. While *Erie* and *Klaxon* make plain that a federal court will apply a choice of law analysis based upon state conflict of laws principles in the State in which it sits, the application of those principles must necessarily yield to the language and intent of the FAA, and if the application of those principles would, through the application of a "public policy" hostile to, or applicable only to, agreements to arbitrate instead of to all contracts generally, that analysis cannot be permitted to void the choice of law made by the parties in their contract. A contrary rule would permit a court to do indirectly what a State may not do directly.

The foregoing authorities make clear that the principles declared by the Montana Supreme Court in *Iwen* in connection with the arbitration clause in that case are not

applicable to contracts generally under Montana law. As a result, those principles may not be applied to the arbitration contract between Choice and respondents, as such rules would be preempted by the FAA under *Casarotto* and *Perry*.

III. THE CONFLICT BETWEEN THE NINTH CIRCUIT AND SEVERAL OTHER CIRCUITS REQUIRES RESOLUTION BY THIS COURT

The opinion of the Ninth Circuit is at odds with the decisions of every other federal court of appeals that has considered the issue of whether an arbitration agreement containing varying obligations and rights on the part of the parties to the agreement should be enforced. In *O'Neil v. Hilton Head Hospital*, 115 F.3d 272, 275-276 (4th Cir. 1997), the district court denied a motion to stay an action filed by an employer in connection with the claim by an employee, who argued that the promise to arbitrate her claims was not supported by adequate consideration, but the Fourth Circuit reversed, holding that because the employer and employee both agreed to be bound by the results of the arbitration, the agreement was enforceable, as a "mutual promise to arbitrate constitutes sufficient consideration for this arbitration agreement."

Similarly, in *Johnson v. Circuit City Stores, Inc.*, 148 F.3d 373, 378 (4th Cir. 1998), *cert. denied*, 530 U.S. 1276 (2000), the district court found that an employment agreement signed by an employee of Circuit City was unenforceable due to lack of consideration because Circuit City failed to affirmatively promise to incur any detriment in exchange for the employee's agreement to arbitrate her

claims against the company, but the Fourth Circuit reversed, finding that since "both parties in this case agreed to be bound by the arbitration process for the resolution of any claim required to be submitted to arbitration under the Dispute Resolution Agreement," the agreement "was supported by adequate consideration," despite the fact that Circuit City was not required to arbitrate any claims it might have had against the employee. *Cf. Hooters of America, Incorporated v. Phillips*, 173 F.3d 933, 938 (1999) (finding that the employer had breached its contractual obligation to promulgate rules and procedures for arbitration by "providing a mechanism for selecting a panel of three arbitrators that is crafted to ensure a biased decisionmaker" from a list of arbitrators created by the employer and otherwise creating rules that were completely one-sided).

The Third Circuit in *Harris v. Green Tree Financial Corporation*, 183 F.3d 173, 183 (3d Cir. 1999) also found that parties to an agreement were not required "to have equivalent obligations to satisfy the standard of mutuality of obligation," and that "the mere fact that Green Tree retains an option to litigate some issues in court, while the Harrises must arbitrate all claims does not make the arbitration agreement unenforceable." The Second Circuit has even gone beyond this principle to hold that mutuality of obligation or remedy is not required to enforce an arbitration agreement if the underlying contract is supported by consideration. *Doctor's Associates, Inc. v. Distajo*, 66 F.3d 438, 451-453 (2d Cir. 1995).

In *Michalski v. Circuit City Stores, Inc.*, 177 F.3d 634, 636 (7th Cir. 1999), the Seventh Circuit reversed the order of the district court denying a motion to stay or dismiss

the action or compel arbitration noting the "Circuit City's promise to be bound by the arbitration process itself serves as mutual consideration." Along the same lines was the decision of the Seventh Circuit in *Kroll v. Doctor's Associates, Inc.*, 3 F.3d 1167, 1171 (1993), in which the court, in response to a claim of lack of mutuality of obligation, stated that "parties can agree to arbitrate some disputes and not others." *Cf. Koveleskie v. SBC Capital Markets, Inc.*, 167 F.3d 361, 366 (7th Cir. 1999), *cert. denied*, 528 U.S. 811 (1999) (finding that a mandatory arbitration agreement contained in a securities industry form "does not create an unconscionable contract of adhesion").

The foregoing cases amply demonstrate not only that the issues involved in the opinion of the Ninth Circuit in the instant case are recurring themes in the development of arbitration law but also that the treatment of these issues by the Ninth Circuit here was *sui generis* among the courts of appeal.

CONCLUSION

The petition for a writ of certiorari in this case should be granted.

Respectfully submitted,

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JAMES L. TICKNOR; JANET TICKNOR; LARRY TICKNOR; TICKCO HOLDING, L.L.C.; TICKNOR LODGING CORPORATION, Plaintiffs-Appellees, v. CHOICE HOTELS INTERNATIONAL, INC., Defendant-Appellant.	No. 00-35048 D.C. No. CV-99-00047-DWM OPINION

Appeal from the United States District Court
for the District of Montana
Donald W. Molloy, District Judge, Presiding

Argued and Submitted
July 19, 2001 – Bozeman, Montana

Filed September 12, 2001

Before: Harry Pregerson, A. Wallace Tashima and Sidney R. Thomas, Circuit Judges.

Opinion by Judge Thomas;
Dissent by Judge Tashima

COUNSEL

Patrick M. Sullivan; Butte, Montana; Attorney for the appellant.

Robert K. Baldwin; Bozeman, Montana; Attorney for the appellee

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OPINION

THOMAS, Circuit Judge:

In this appeal, we consider whether the Federal Arbitration Act preempts state law governing the unconscionability of adhesion contracts. Under the circumstances presented by this case, we conclude that it does not, and we affirm the order of the district court denying the motion to compel arbitration.

I

In 1998, James Ticknor and the Ticknor Lodging Corporation (collectively, "Ticknor") executed an Econo Lodge Franchise Agreement ("Franchise Agreement") with Choice Hotels, International, Inc. ("Choice") for the operation of a hotel located in Bozeman, Montana. In return for the payment of franchise fees, Ticknor was granted a non-exclusive license to use the Econo-Lodge mark in connection with the motel. In addition, Choice was to integrate the motel into its national advertising and reservations system and provide other assistance. James Ticknor's parents, Janet and Larry Ticknor and Tickco Holding LLC (their company) guaranteed the performance of the Agreement. Ticknor and Ticknor Lodging also executed the separate guaranty agreement ("Guaranty Agreement").

The Franchise Agreement, which was a pre-printed standard form instrument drafted by Choice, contained an arbitration clause providing:

> Except for our claims against you for indemnification, actions for collection of moneys owed us under this Agreement, or actions seeking to enjoin you from using the Marks in violation of this Agreement, any controversy or claim relating to this Agreement, or the breach of this Agreement, including any claim that this Agreement or any part of this Agreement is invalid, illegal, or otherwise voidable or void, will be sent to final and binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitrator will apply the substantive laws of Maryland, without reference to its conflict of laws provision. Judgment on the arbitration award may be entered in any court having jurisdiction. If any party fails to appear at any properly noticed arbitration proceeding, an award may be entered against the party, notwithstanding its failure to appear. Any arbitration will be conducted at our headquarters office in Maryland.

The Franchise Agreement also contained a choice of law provision that stated: "This Agreement becomes valid only when we have signed it, and it will be interpreted under the substantive laws of Maryland, not including its conflict of laws provision."

The Guaranty Agreement did not contain either an arbitration clause or a choice of law provision. However, it did provide in relevant part that:

> the undersigned do jointly and severally, unconditionally and irrevocably, guaranty to Choice

> that Ticknor Lodging Corporation . . . and James L. Ticknor, Individually, Jointly and Severally, . . . will perform throughout the term of the Agreement each and every covenant, payment or obligation on the part of the Franchisee contained and set forth in said Agreement.

Subsequently, the parties executed two contract addendums drafted by Choice. The first reduced the amount of liquidated damages potentially payable. The second required Ticknor to make certain facility improvements, but allowed him to operate the motel pending implementation of some of those upgrades. According to Ticknor, Choice had promised to provide technical and financial assistance in the renovation of the motel exterior through its "Signature Exterior Renovation Program."

The ink was hardly dry on the Franchise Agreement when disputes arose. Choice canceled the "Signature Exterior Renovation Program," which Ticknor claims was a material inducement to his assent to the Franchise Agreement. In addition, Ticknor alleges that the Choice reservation system was flawed, resulting in overbookings. As a result of these disagreements, Ticknor suspended payment of the franchise fee. Choice thereupon notified Ticknor that it was suspending the Franchise Agreement. Choice also filed a demand for arbitration with the American Arbitration Association ("AAA"), whereupon Ticknor sought and received a state court temporary restraining order prohibiting Choice from proceeding with arbitration. Choice then removed the state court action to federal court and filed a motion to dismiss or, alternatively, to compel arbitration. The district court

declined Ticknor's application for a temporary restraining order. Choice withdrew its arbitration request with the AAA. After an evidentiary hearing, the district court denied Choice's motion to dismiss and alternative motion to compel arbitration. This appeal followed.

We review *de novo* a district court's order denying a petition to compel arbitration, including its interpretation of the validity and scope of the arbitration clause. *Chiron Corp. v. Ortho Diagnostic Sys. Inc.*, 207 F.3d 1126, 1130 (9th Cir. 2000). "[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). We review the factual findings underlying the district court's decision for clear error. *Woods v. Saturn Distrib. Corp.*, 78 F.3d 424, 427 (9th Cir. 1996). The interpretation and meaning of contract provisions are questions of law we review *de novo*. *Simula, Inc. v. Autoliv, Inc.*, 175 F.3d 716, 719 (9th Cir. 1999). We also review *de novo* the district court's decision concerning the appropriate choice of law. *Aceves v. Allstate Ins. Co.*, 68 F.3d 1160, 1167 (9th Cir. 1995).

II

The Federal Arbitration Act ("FAA") provides that written agreements to arbitrate disputes arising out of transactions involving interstate commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The FAA " 'creates a body of federal substantive law of arbitrability,' enforceable in both state and federal courts and pre-empting any state

laws or policies to the contrary." *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988) (quoting *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24).

Despite the "liberal federal policy favoring arbitration agreements," *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 81 (2000), state law is not entirely displaced from federal arbitration analysis. Under § 2, "state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) (emphasis in original). "Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 686 (1996). "Courts may not, however, invalidate arbitration agreements under state laws applicable only to arbitration provisions." *Id.* Thus, "Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.' " *Id.* (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)). In short, as long as state law defenses concerning the validity, revocability, and enforceability of contracts are generally applied to all contracts, and not limited to arbitration clauses, federal courts may enforce them under the FAA.

Of course, the role of the federal courts in these circumstances is limited: the sole question is whether the arbitration clause at issue is valid and enforceable under § 2 of the Federal Arbitration Act. *Chiron Corp.*, 207 F.3d at 1130. In making this determination, federal courts may

not address the validity or enforceability of the contract as a whole. *Prima Paint v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 401 (1967).

III

Ticknor has raised the state law defense of unconscionability to Choice's motion to compel arbitration. Before assessing whether that defense is viable, we must determine which state's law applies. Federal courts sitting in diversity look to the law of the forum state in making a choice of law determination. *Sparling v. Hoffman Constr. Co., Inc.*, 864 F.2d 635, 641 (9th Cir. 1988); *see also Zinser v. Accufix Research Institute, Inc.*, ___ F.3d ___ (9th Cir. 2001). Thus, because the complaint was filed in Montana, Montana's choice of law rules apply.

Montana applies the Restatement (Second) of Conflict of Laws § 187(2) "when [it is] faced with the question of whether to give effect to a contractual choice of law by the parties." *Keystone, Inc. v. Triad Sys. Corp.*, 971 P.2d 1240, 1242 (1998). That section provides, in relevant part, that:

> The law of the state chosen by the parties to govern their contractual rights and duties will be applied . . . unless . . .
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the role of section 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Restatement (2d) of Conflict of Laws § 187(2) (1988).

Montana courts conflate the latter two inquiries and find that whichever state has a materially greater interest under § 188 is also the state whose law would apply absent an effective choice of law provision. *See Keystone*, 971 P.2d at 1242. Thus, to overcome the parties' choice of law contractual provisions, (1) Montana must have a materially greater interest in the transaction than Maryland and (2) application of the law of Maryland must be contrary to a fundamental public policy of Montana in the determination of the arbitration clause's validity.

To determine which state has a materially greater interest, Montana law relies on the five factors enumerated in Restatement (Second) of Conflict of Laws § 188, namely:

> (a) the place of contracting;
>
> (b) the place of negotiation of the contract;
>
> (c) the place of performance;
>
> (d) the location of the subject matter of the contract; and
>
> (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

Keystone, 971 P.2d at 1242.

After applying these factors, the district court determined that Montana has a materially greater interest than Maryland in the transaction. In making this analysis, the district court made the following factual findings:

> (a) The contract was signed in both Montana and Maryland.

(b) Negotiations took place between James Ticknor and a Choice representative in Montana.

(c) Most of the contract obligations were performed in Montana (i.e., the operation of the hotel by the Ticknors), except that the Ticknors mailed fees to Maryland.

(d) The subject matter of the contract – the Econo-Lodge motel – is located in Butte, Montana.

(e) The Ticknors live and work in Montana

These findings were inaccurate in some respects: James Ticknor executed the contract not in Montana, but on vacation in Mexico while he was a Colorado resident; Larry and Janet Ticknor were residents of South Dakota, not Montana; and the motel is located in Bozeman – not Butte. However, the discrepancies do not alter our agreement with the district court's ultimate conclusion that Montana has a materially greater interest than Maryland in the transaction. The purpose of the contract was to establish and govern operation of a motel franchise in Montana. The motel was operated in Montana. The only face-to-face meeting between Choice representatives and James Ticknor occurred in Montana. James Ticknor has never traveled to Maryland. Maryland provided an address for depositing payments, but little else. As in *Keystone*, "the contract was performed almost exclusively in Montana" and "the subject matter of the contract is located in Montana." 971 P.2d at 1243. Thus, under Montana choice of law principles, Montana has a materially greater interest in the transaction than does Maryland.

Having determined this, the second question is whether application of the law of Maryland in this context would be contrary to a fundamental public policy of Montana. Assuming, *arguendo*, that Maryland law would differ from Montana's on the salient question, application of foreign law would contradict a fundamental public policy of Montana. The Montana Supreme Court has taken a broad view of what constitutes public policy, declaring that "[f]or choice of law purposes, the public policy of a state is simply the rules, as expressed in its legislative enactments and judicial decisions, that it uses to decide controversies." *Phillips v. Gen. Motors Corp.*, 298 Mont. 438, 995 P.2d 1002, 1015 (2000). The Montana Supreme Court has also expressed antipathy toward choice of law provisions that might require enforcement of a contractual provision that would be invalid under Montana law. *See, e.g., Miller v. Fallon County*, 721 P.2d 342, 347 (1986) (holding that contracts with non-Montana choice of law provisions that violate public policy are "the types of contracts Montana will refuse to recognize regardless of their origin").

In the context of adhesion contracts, the Montana Supreme Court has determined expressly that it will not enforce an arbitration clause that "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter." *Iwen v. U.S. West Direct*, 293 Mont. 512, 977 P.2d 989, 996 (1999). In short, an unconscionable arbitration clause in an adhesion contract is unenforceable in Montana as a matter of public policy. Thus, the district court did not err in concluding that the Montana Supreme Court would likely hold that another

state's contrary interpretation of contract unconscionability would contradict a fundamental public policy of Montana. For these reasons, the district court also properly concluded that the question of whether the arbitration clause was unconscionable should be determined by application of Montana law.

IV

"The task of a federal court in a diversity action is to approximate state law as closely as possible in order to make sure that the vindication of the state right is without discrimination because of the federal forum." *Gee v. Tenneco, Inc.*, 615 F.2d 857, 861 (9th Cir. 1980). In doing so, federal courts are bound by the pronouncements of the state's highest court on applicable state law. *Davis v. Metro Productions, Inc.*, 885 F.2d 515, 524 (9th Cir. 1989). "Where the state's highest court has not decided an issue, the task of the federal courts is to predict how the state high court would resolve it." *Dimidowich v. Bell & Howell*, 803 F.2d 1473, 1482 (9th Cir. 1986), *modified at* 810 F.2d 1517 (9th Cir. 1987). In assessing how a state's highest court would resolve a state law question – absent controlling state authority – federal courts look to existing state law without predicting potential changes in that law. *Moore v. R.G. Industries, Inc.*, 789 F.2d 1326, 1327 (9th Cir. 1986).

The district court concluded that, under Montana law, the arbitration provision in the Franchise Agreement is unenforceable as unconscionable. In making that determination, the district court relied on the Montana Supreme Court's recent decision in *Iwen*, 977 P.2d at

994-95, in which the Montana Supreme Court invalidated an arbitration agreement almost identical to the provision at issue.

To determine the enforceability of a specific contractual provision under *Iwen*, a Montana court must first decide whether the contract is one of adhesion. 977 P.2d at 994-95. If so, then the provision will not be enforced against the weaker contracting party if it is (1) not within that party's reasonable expectations, or (2) if within those expectations, it is unduly oppressive, unconscionable, or against public policy. 977 P.2d at 994-95 (citing *Passage v. Prudential-Bache Sec., Inc.*, 727 P.2d 1298, 1302 (1986)).

The district court concluded that the Franchise Agreement was a contract of adhesion under Montana law, and we find no error in that determination. Like the contract at issue in *Iwen*, the Franchise Agreement was a standardized, form agreement that Ticknor was forced to accept or reject without negotiation. Choice argues that the presence of two addenda indicate that the contract was negotiable. However, the record belies this. The addenda were drafted by Choice after a site visit and presented to Ticknor in the same "take it or leave it" manner as the original Franchise Agreement. There is no evidentiary support in the record for Choice's argument that Ticknor negotiated the changes embodied in the addenda. In fact, Ticknor testified that he had not requested Addendum No. 1, which reduced Ticknor's liquidated damages, and that it was added by Choice unilaterally "because of the disagreements they'd had with franchisees in the past." He also testified that the second addendum, which listed specific changes and additions Ticknor was required to make to the hotel, was

created after Rod McKee, one of Choice's management personnel, inspected the Bozeman hotel site without Ticknor's presence or input. To dispute this, Choice submitted the affidavit of its Senior Vice President and General Counsel, Michael J. Desantis, stating that, "[a]ccording to [Choice's business] records, plaintiffs . . . negotiated several changes to [the Agreement]." However, Desantis did not participate in any such negotiations (Ticknor had never even met him), and Choice did not present any of the business records that purportedly reflected the negotiations. Given these facts, we conclude that the district court did not err in concluding that the Franchise Agreement was an adhesion contract under Montana law.

The fact that a contract is one of adhesion is not dispositive under Montana law. *Passage v. Prudential-Bache Sec., Inc.*, 727 P.2d 1298, 1302 (1986) ("We conclude that even if the customer agreement form is an adhesion contract, there is nothing in the record and no compelling law to prevent enforcement of the arbitration clause."). The second step in the *Iwen* analysis is to ascertain whether the contract is (1) not within that party's reasonable expectations, or (2) if within those expectations, it is unduly oppressive, unconscionable, or against public policy. 977 P.2d at 994-95. Here, the district court concluded that the arbitration clause was unconscionable under Montana law because it required binding arbitration of the weaker bargaining party's claims, but allowed the stronger bargaining party the opportunity to seek judicial remedies to enforce contractual obligations. There is no requirement under Montana law that "arbitration agreements must contain mutual promises that give parties identical rights and obligations or that the parties must

be bound in the exact same manner." *Id.* at 996. However, "the disparities in the rights of the contracting parties must not be so one-sided and unreasonably favorable to the drafter . . . that the agreement becomes unconscionable and oppressive." *Id.*

The arbitration clause in this case allowed Choice to bring its claims against Ticknor into state or federal court, yet forced Ticknor to submit all claims to binding arbitration at Choice's headquarters in Maryland. *Iwen* involved an almost identical situation, leading the Montana Supreme Court to reach the conclusion that the clause was unenforceable. *Id.* at 993. Thus, applying *Iwen*, the arbitration provision in this case "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter." *Id.* at 996.

Choice suggests that, because it initially sought arbitration as to whether franchise fees were due – which it was not obligated to do under the Franchise Agreement – mutuality of arbitration remedy exists under the contract. However, it is the contractual terms, not the subsequent behavior of the parties, that determines whether a clause may be deemed unenforceable as unconscionable. *See id.* In addition, Choice has withdrawn its request for arbitration of its affirmative claims, removing the factual underpinnings of its argument.

It is arguable that Montana law as established by *Iwen* and its predecessors is limited to consumer contracts – where the inequality of bargaining power is readily apparent – and does not apply to a commercial transaction between supposedly sophisticated business owners. In the past, Montana law has occasionally evolved in

similar contexts. *Compare Dunfee v. Baskin-Robbins, Inc.* 720 P.2d 1148, 1153 (1986), *with Story v. City of Bozeman,* 791 P.2d 767, 773 (1990). However, as written, *Iwen* is not limited to the consumer context; in fact, it applied "generally applicable contract defenses." 977 P.2d at 944. In addition, the Montana Supreme Court had previously held that "[o]ppression and a disparity of bargaining power are the indicia of unconscionability relating to a sales contract between two business professionals." *In re Michael,* 871 P.2d 272, 275 (1994) (citing *All-States Leasing v. Top Hat Lounge,* 649 P.2d 1250, 1253 (1982)). Thus, it would be entirely speculative to conclude that the Montana Supreme Court might in the future be inclined to "review the current state of the law and to make mid-course corrections." *Story,* 791 P.2d at 772. In analyzing state law in diversity cases, we must take the law as we find it – not how we might imagine that it might or should evolve. *Moore,* 789 F.2d at 1327.

In view of these considerations, we conclude that the district court correctly determined that the Montana Supreme Court would likely hold that the arbitration provision of the Franchise Agreement was unenforceable as unconscionable under Montana law.

V

The fact that the arbitration provision is unenforceable under Montana law does not end our inquiry; we must also determine whether Montana's construction of the unconscionability of arbitration clauses is preempted by the Federal Arbitration Act. That analysis is guided by the Supreme Court's decision in *Doctor's Associates,*

another case originating from Montana. Under *Doctor's Associates*, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." 517 U.S. at 687, 116 S.Ct. 1652. However, "[c]ourts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." 517 U.S. at 687, 116 S.Ct. 1652 (emphasis in original). In other words, state legislation specifically aimed at arbitration agreements is preempted by the Federal Arbitration Act. In all situations where arbitration provisions are "placed upon the same footing as other contracts," *see id.* (internal quotation marks and citation omitted), state law applies.

The Montana Supreme Court addressed the limitations of *Doctor's Associates* in *Iwen*, explaining that Montana law pertaining to the unconscionability of arbitration clauses was the result of the "application of general principles that exist at law or in equity for the revocation of any contract." 977 P.2d at 996. Thus, Montana law concerning arbitration clauses in adhesion contracts does not run afoul of *Doctor's Associates*.

The Supreme Court's decision in *Doctor's Associates* does, however, cause us to reconsider our prior decisions in *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 286 (9th Cir. 1988), and *Bayma v. Smith Barney, Harris Upham and Co.*, 784 F.2d 1023 (9th Cir. 1986). Because certain aspects of *Cohen* and *Bayma* cannot be reconciled with *Doctor's Associates*, we must overrule them insofar as they hold that state law adhesion contract principles may not be invoked to bar arbitrability of disputes under the Arbitration Act. *See Interactive Flight Techs., Inc. v. Swissair Swiss Air Transport Co., Ltd.*, 249 F.3d 1177, 1179 (9th Cir.

2001) (applying rule that three-judge panels may depart from circuit precedent that is inconsistent with an intervening Supreme Court decision).

VI

In sum, the district court did not err in denying the motion to dismiss or, in the alternative, to compel arbitration. The arbitration clause in the Franchise Agreement was unenforceable as unconscionable under Montana law, which was not preempted by the Federal Arbitration Act.

AFFIRMED.

TASHIMA, Circuit Judge, dissenting:

Because I do not believe that the contract at issue was an adhesion contract or that its arbitration clause was so one-sided as to make it unconscionable, I respectfully dissent. The arbitration clause does not violate Montana's public policy; therefore, Maryland law should apply. Because I also conclude that Maryland law would not prevent the enforcement of the arbitration clause, I would reverse the district court's denial of Choice's motion to dismiss or to compel arbitration.[1]

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[1] Although not entirely free from doubt, I accept for purposes of this dissent the majority's conclusion that the judicially-created Montana rule, making one-sided arbitration clauses in adhesion contracts unenforceable, does not run afoul of *Doctor's Assoc., Inc. v. Casarotto*, 517 U.S. 681 (2000). *See* maj. op. at 13092. Similarly, it is not at all clear, contrary to the majority's assertion, that "Montana has a materially greater interest in the transaction than does Maryland," *id.* at 13087, in

The concept of adhesion first arose in the insurance context, *see Fitzgerald v. Aetna Ins. Co.*, 577 P.2d 370, 373 (1978) (finding "insurance policy [to be] an adhesion contract"), but has since been applied to other areas. *See, e.g., Anderson v. Baker*, 641 P.2d 1035, 1039 (1982) (consumer and bank); *Passage v. Prudential-Bache Sec., Inc.*, 727 P.2d 1298, 1301 (Mont. 1986) (finding a contract of adhesion where consumer was "faced with an industry wide practice of including Arbitration Clauses in standardized brokerage contracts" and thus "face[d] the possibility of being excluded from the securities market unless he accept[ed] a contract with such an agreement to arbitrate"); *Iwen v. U.S. West Direct*, 977 P.2d 989, 995 (Mont. 1999) (finding a contract of adhesion between a consumer and telephone company because consumer had no opportunity to negotiate agreement for advertising in the Yellow Pages). As these cases demonstrate, however, Montana has used the adhesion doctrine to protect unsophisticated *consumers* in consumer transactions with no meaningful choice. The rule of adhesion has never been applied to commercial contracts between sophisticated business organizations.[2]

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this action in which none of the parties is a resident or domiciliary of, or is headquartered in, Montana. I accept this conclusion also, however, for the purposes of the analysis that follows.

[2] Recognizing that its application of the adhesion doctrine to this commercial contract is anomalous, the majority purports to "take the law as we find it." Maj. op. at 10392. In its very next sentence, however, the majority concedes that what it in fact is doing is predicting what "the Montana Supreme Court would likely hold." *Id.*

Plaintiffs are not unsophisticated "consumers" under any definition of the term and this is not a consumer transaction. Ticknor Lodging Corp., the contracting party and primary plaintiff, owns and operates at least two hotel properties-the one at issue and another in Colorado. Plaintiffs have been operating these properties under franchise agreements with two separate franchisors-one with Prime Rate and the other with Redwood Lodge. Ticknor is an experienced and sophisticated motel franchise operator. Additionally, unlike the plaintiffs in the cases cited above, the Ticknors have not demonstrated that they had no other viable alternatives, *i.e.*, that they "face [d] the possibility of being excluded from the [hotel franchise] market unless [they] accept[ed] a contract with such an agreement to arbitrate." *Passage*, 727 P.2d at 1301.[3] Rather, the record suggests that plaintiffs made a conscious decision to change their affiliation because they believed that the Econo Lodge mark and system would increase their profitability. They willingly accepted the negotiated burdens of the new franchise agreement in return for the expected benefits of the Econo Lodge

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[3] Indeed, plaintiffs presumably could have continued their relationship with Prime Rate.

mark.[4] In other words, plaintiffs had not only a theoretical, but also an actual, choice. No adhesion contract was crammed down their throat.

This is in direct contrast to the case solely relied upon by the majority. In *Iwen*, the plaintiff-a consumer seeking to place an ad in the Yellow Pages-was faced with a Hobson's choice: either accept the contract as presented, or forego advertising with the only publisher of Yellow Pages in the relevant marketing area. On that fact alone, the case is distinguishable.[5]

Furthermore, even if the contract is one of adhesion, I do not agree that *Iwen* dictates a finding of unconscionability. It is true, as the Majority contends, that the parties' obligations to arbitrate differ in some respect.[6]

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[4] Contrary to the majority's assertion, this was a negotiated transaction. In its choice of law analysis, the district court expressly found that "*[n]egotiations took place* between James Ticknor and a Choice representative in Montana." Maj. op. at 13086 (emphasis added). The majority does not challenge this finding as clearly erroneous; in fact, it relies on it in concluding that the district court's choice of law analysis was correct.

[5] Under the majority's rule, every form contract between parties of even slightly unequal bargaining power is a contract of adhesion – and thus is prone to invalidation. Clearly, the Montana Supreme Court did not envision such a rule.

[6] These differences, however, are immaterial to the mutuality analysis. Choice reserved its right to sue for three things: indemnity, trademark enforcement, and moneys owed under the contract. At first glance, it may seem unfair to allow Choice, but not Ticknor, to sue for these breaches. But, Ticknor does not have a right of indemnification against Choice, nor does it have any trademark rights to protect. It makes sense that indemnification claims are not required to be arbitrated because

But should either party wish to proceed against the other for almost any obligation *under the contract*, that party must do so through arbitration. Thus, in that respect, there is complete mutuality of obligations.[7] By comparison, in *Iwen*, "the sole remedy for either party [was] the cost of the advertisement." 977 P.2d at 996. In enforcing this remedy, the "stronger" party could go to court while the "weaker" party was limited to arbitration. *Id.* at 995-96. The court found that arrangement unconscionable. Once again, the parties' remedies here are not so limited. As such, the clause is not so one-sided as to be unconscionable under Montana law.

We recently noted that the unconscionability analysis has two prongs- procedural unconscionability (the manner and circumstances of contract formation, *i.e.*, was it

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they invariably arise out of third-party claims which are often already in litigation, where the convenient remedy, if tender of the defense is rejected, is to bring a third-party claim for indemnification. As for trademark claims, the classic remedy for infringement is a federal court injunction, a remedy an arbitrator has no power to enforce. Furthermore, Ticknor could not file an action for "collection of moneys . . . under this Agreement" because Choice has no monetary obligations to Ticknor under the contract. Thus, in the mutuality analysis, it makes no difference that Choice is not required to arbitrate these claims. Like the Ticknors, Choice is required to arbitrate all of its other claims under the agreement.

[7] For instance, any breach by Ticknor unrelated to payment of monies owed would be arbitrable. Such breaches, for example, could include a failure to follow the aesthetic rules or a failure to maintain insurance. Ironically, in fact, in this case, it was Choice who sought to arbitrate *its claims* under the agreement and plaintiffs who are attempting to avoid arbitration of Choice's claims.

truly a contract of adhesion), and substantive unconscionability (which analyzes the terms of the agreement, *i.e.*, is so one-sided as to *shock the conscience*). *Soltani v. West. & So. Life Ins. Co.*, No. 9956612, 2001 WL 877156, at *3-*4 (9th Cir. Aug. 6, 2001). Although *Soltani* was a case under California law, our analysis here should proceed in the same way, with the same objective. Under such an analysis, this clearly is not an unenforceable adhesion contract-there was neither procedural unconscionability nor substantive unconscionability-and the agreement should be enforced. *See id.*

Because the arbitration clause does not violate Montana law, the parties' choice of law should be enforced and Maryland law applied to this dispute. Maryland courts "treat the mutual promises to arbitrate as an independently enforceable contract. The parties have exchanged mutual promises to arbitrate disputes under the contract and each promise provides consideration for the other." *Holmes v. Coverall N. Am., Inc.*, 649 A.2d 365, 370 (Ct. App. Md. 1994). Thus, as long as "there are no infirmities in the formation of the arbitration agreement itself; that is, that there is a mutual exchange of promises to arbitrate, . . . [the court's] inquiry ceases, as the agreement to arbitrate has been established as a valid and enforceable contract." *Id.* Here, as stated above, there is a mutual exchange of promises to arbitrate mutually-assertable claims. Therefore, under Maryland law, the arbitration clause is enforceable.

The district court's order should be reversed and the case remanded with directions to grant Choice's motion to compel arbitration.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
BUTTE DIVISION

JAMES L. TICKNOR, JANET TICKNOR, LARRY TICKNOR, TICKCO HOLDING, L.L.C., and TICKNOR LODGING CORPORATION, Plaintiff, vs. CHOICE HOTELS INTERNATIONAL, INC., Defendant.	CV 99-47-BU-DWM ORDER (Filed Dec. 6, 1999)

Before the Court are Defendant Choice's motion to dismiss or, in the alternative, to compel arbitration, and Plaintiff Ticknors' motion for a preliminary injunction against arbitration. The Ticknors filed this action seeking a declaratory judgment that the arbitration clause in the franchise contract between the parties was invalid and unenforceable.

I. Factual & Procedural Background

On February 24, 1998, James Ticknor and Ticknor Lodging Corp., signed an EconoLodge Franchise Agreement ("the Agreement") with Choice Hotels, Inc. On the same date, Larry and Janet Ticknor and Tickco Holding Co., LLC, as well as James Ticknor, signed a Guaranty referring to the Agreement. Choice signed on March 10,

1998. The Agreement required Choice to provide the Ticknors with a nonexclusive license to use EconoLodge trademarks, integration into its national advertising and reservations system, hardware and software to make the reservation system operable, and a manual governing the daily operation of the hotel (Agreement ¶ 5(c), (d)). The Ticknors were obligated to pay franchise fees (¶ 4), operate the hotel in conformity with EconoLodge standard practices (¶ 6), and upgrade the hotel to bring it into conformity with standard EconoLodge layout (Agreement Addendum No. 2).[1]

After the Agreement was signed, Choice announced cancellation of its "Signature Exterior Renovation Program," obviating any possibility for the Ticknors to obtain assistance with the upgrade. The Ticknors allege that the reservation system was faulty as well, resulting in overbooking, and that the relationship between hardware and software was less than harmonious. Consequently, the Ticknors suspended their performance.

On March 23, 1999, Choice notified the Ticknors that it was terminating the Agreement, effective immediately, because the Ticknors defaulted in payment of their franchise and related fees. On July 8, 1999, Choice filed a demand for arbitration with the American Arbitration Association. The Ticknors filed a complaint in state court on August 9, 1999, seeking a temporary restraining order and preliminary injunction prohibiting Choice from proceeding with arbitration. On August 16, Choice removed

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[1] The parties question the scope of the Guaranty. I refer to "the Ticknors" collectively only for the sake of convenience.

the case to this Court. On August 19, Choice moved to dismiss or, in the alternative, to compel arbitration.

The Court denied the Ticknors' application for a temporary restraining order on September 9. I heard oral argument on their motion for a preliminary injunction on September 15. At the hearing, Choice agreed to delay arbitration proceedings until the motions were decided. On October 18, Choice filed a notice of withdrawal of the July 8 demand for arbitration. Choice's motion to dismiss or compel arbitration remains pending, as does the Ticknors' motion for a preliminary injunction.

II. Analysis

The Ticknors argue that the arbitration clause is unenforceable under Montana law because it is part of an unconscionable contract of adhesion. Choice argues that the clause is valid and enforceable because the contract is not one of adhesion. Choice also argues that Maryland law should apply because the contract contains a choice of law provision.

A. Choice of Law

There is no dispute that the action falls under the Federal Arbitration Act ("the Act"). 9 U.S.C. § 2 provides that a written agreement to arbitrate a contract "evidencing [a] transaction[ ] in commerce" is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." As an exercise of Congress' Commerce Clause powers, the

phrase "transaction in commerce" is very broadly construed and undoubtedly includes franchise agreements. *See, e.g., Southland Corp. v. Keating*, 465 U.S. 1 (1984) (assuming that a 7-Eleven franchise agreement evidences a transaction in interstate commerce). Thus, the Act applies to this case.

However, state law provides the law of decision. *See* 9 U.S.C. § 2. When a Montana court, state or federal, must decide whether to give effect to a choice of law provisions, it must consider the Restatement (Second) of Conflict of Laws § 187(2) (1971). *Keystone, Inc. v. Triad Sys. Corp.*, 1998 MT 326, ___ Mont. ___, 971 P.2d 1240 (Mont. 1998); *Casarotto v. Lombardi*, 268 Mont. 369, 886 P.2d 931 (Mont. 1994), *rev'd on other grounds, Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996); *Rindal v. Seckler*, 786 F. Supp. 890 (D. Mont. 1992).

Under the Restatement, the choice of law provision prevails unless "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which . . . would be the state of the applicable law in the absence of an effective choice of law by the parties." Restatement (Second) of Conflict of Laws § 187(2)(b) (1971).

Section 188 of the Restatement determines which state has a materially greater interest and which state's law would apply absent the parties' choice of law. Five factors are considered: (a) the place of contracting; (b) the place of negotiation of the contract; (c) the place of performance; (d) the location of the subject matter of the

contract; and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties. Restatement (Second) of Conflict of Laws § 188(2).

In this case, the contract was signed in both Montana and Maryland. Negotiations took place between James Ticknor and a Choice representative in Montana. The parties performed most of their obligations in Montana, although the Ticknors mailed their franchise and related fees to Maryland. The EconoLodge was located in Butte, Montana. Choice is incorporated in Delaware and has its headquarters in Maryland. The Ticknors live and work in Montana. The subject matter of the contract, the place of performance, and the negotiations preceding the Agreement all are rooted in Montana. Clearly, Montana has a greater material interest in this Agreement, and Montana's law would govern absent the parties' choice of Maryland law.

The next question is whether application of Maryland law would defeat a fundamental public policy of Montana. Montana decisional law is clear that choice of forum provisions contravene Montana public policy. *See Rindal*, 786 F. Supp. at 894; *State ex rel. Polaris Indus.*, 215 Mont. at 111, 695 P.2d at 472. However, the Montana Supreme Court has not determined whether application of Maryland law would defeat Montana public policy when the particular issue to be decided is not choice of forum but unconscionability.

This determination is not difficult to make. "Unconscionable" is but another name for "contrary to fundamental policy." It stands to reason that determination of unconscionability issues under another state's law would

be contrary to Montana's fundamental policy of protecting its citizens from agreements that are contrary to Montana's fundamental policies. Applying Maryland law to determine this issue would be unconscionable.[2]

The Ninth Circuit has stated that "state law adhesion contract principles may not be invoked to bar arbitrability of disputes under the [Federal] Arbitration Act." *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 286 (9th Cir. 1988) (citing *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F.2d 1023, 1024-25 (9th Cir. 1986). The *Bayma* decision is no longer good law, if it ever was. The Federal Arbitration Act itself makes state law the law of decision. *See* 9 U.S.C. § 2 (a written agreement to arbitrate a contract is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."). The United States Supreme Court honors that language. *See Doctor's Assocs., Inc.*, 517 U.S. at 687 ("[T]he text of § 2 declares that state law may be applied 'if that law arose to govern issues concerning the

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[2] Note that this arbitration clause is probably unenforceable under Maryland law. *See, e.g., Holmes v. Coverall N. Am. Inc.*, 649 A.2d 365, 369-70 (Md. 1994) (discussing separability doctrine and *Hull v. Norcom, Inc.*, 750 F.2d 1547, 1550 (11th Cir. 1985), which "refus[ed] to enforce arbitration clause in case alleging fraud in the inducement of a contract because the unilateral ability of one of the parties to bring certain claims in court evidenced insufficient consideration to support the validity of the arbitration clause."). Here, however, the question is not whether the arbitration clause would be enforceable under Maryland law but whether Montana or Maryland should apply to determine whether the arbitration clause is enforceable.

validity, revocability, and enforceability of contracts generally.' ") (quoting *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987)). Moreover, there is no federal law of contracts and there is no federal test of unconscionability. State law *must* supply the laws and tests to determine whether an arbitration clause is enforceable.

B. The Arbitration Clause Under Montana Law

In the light of Montana law, the arbitration clause must be examined in isolation from the remainder of the contract. That a contract as a whole is one of adhesion under state law principles will not preclude arbitration. *Republic of Nicaragua v. Standard Fruit Co.*, 937 F.2d 469, 476 (9th Cir. 1991), pointed out that "[a]n arbitration clause may thus be enforced even though the rest of the contract is later held to be invalid by the arbitrator" (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967)). In other words, it is up to the arbitrator to decide whether the contract is enforceable; the court may only decide whether the arbitration clause is enforceable.

The arbitration clause, in full, provides:

> ¶ 22. Arbitration. Except for our claims against you[3] for indemnification, actions for collections of moneys owed us under this Agreement, or actions seeking to enjoin you from using the Marks in violation of this Agreement, any controversy or claim relating to this Agreement, or the breach of this Agreement, including any

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[3] Choice is the party of the first-person plural; the Ticknors are the party of the second-person plural.

> claim that this Agreement or any part of this Agreement is invalid, illegal, or otherwise voidable or void, will be sent to final and binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitrator will apply the substantive laws of Maryland, without reference to its conflict of laws provision. Judgment on the arbitration award may be entered in any court having jurisdiction. If any party fails to appear at any properly noticed arbitration proceeding, an award may be entered against the party, notwithstanding its failure to appear. Any arbitration will be conducted at our headquarters office in Maryland.

This clause plainly does not state that the parties agree to submit disputes concerning Choice's entitlement to "moneys owed us under this Agreement" to arbitration. It *excepts* Choice's claims for such moneys from matters that "will" be arbitrated.

Despite the strong Congressional policy favoring arbitration, a party cannot be compelled to arbitrate if it has not agreed to do so. Neither party agreed that Choice's claims would be arbitrated. Consequently, Choice's motion to compel the Ticknors to arbitrate, insofar as Choice contemplates arbitration of its franchise fee claim, must be denied.

Furthermore, insofar as the arbitration clause purports to compel the parties to arbitrate in Maryland, it is clearly invalid under Montana law. *See Keystone, Inc. v. Triad Sys. Corp.*, 1998 MT 326, ___ Mont. ___, 971 P.2d

1240, 1242-43 (Mont. 1998) (holding choice of forum provision invalid, readopting Restatement (Second) of Conflict of Laws § 187(2) (1971), and reaffirming *Casarotto v. Lombardi*, 268 Mont. 369, 886 P.2d 931 (Mont. 1994), *rev'd on other grounds, Doctor's Assocs. Inc.*, 517 U.S. at 687-88).

However, the motion to compel could apply to the Ticknors' claims for declaratory judgment that Choice is not entitled to its franchise and related fees and that the Ticknors are entitled to rescission, damages for breach of contract, negligent misrepresentation, and actual and constructive fraud, and to punitive damages. Thus, the Court must still decide whether those issues are arbitrable.

In the recent case of *Iwen v. U.S. West Direct*, 1999 MT 63, ___ Mont. ___, 977 P.2d 989 (Mont. 1999), the Montana Supreme Court reversed a trial court's order of arbitration on the grounds that the arbitration provision was unconscionable in a contract of adhesion. *Iwen* concerned an arbitration clause strikingly similar to the clause in Choice's franchise agreement:

> Any controversy or claim arising out of or relating to this Agreement, or breach thereof, other than an action by the Publisher for the collection of the amounts due under this Agreement, shall be settled by final, binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association.

Iwen at ¶ 31, 977 P.2d at 995.

To determine whether this clause was enforceable, the Montana Supreme Court applied three analytic steps. First, it determined whether the contract was one of

adhesion. Second, it determined whether the provision could pass a two-prong test for validity: (a) the provision must be within the reasonable expectations of the weaker party and (b) it must not be unduly oppressive, unconscionable, or against public policy when considered in context. *See Passage v. Prudential-Bache Sec., Inc.*, 223 Mont. 60, 66, 727 P.2d 1298, 1302 (Mont. 1986).

In Montana, contracts of adhesion "arise when a standardized form of agreement, usually drafted by the party having superior bargaining power, is presented to a party whose choice is either to accept or reject the contract without the opportunity to negotiate its terms." *Iwen* at ¶ 28, 977 P.2d at 995. Testimony at the hearing established that the arbitration clause, along with the rest of the agreement, was presented as a "take it or leave it" proposition, although the parties did add one addendum to the standard agreement.[4] Choice drafted the agreement. Considering only the arbitration clause, the evidence indicates it is a contract of adhesion.

The next question is whether the arbitration agreement either violated the Ticknors' reasonable expectations or was unduly oppressive, unconscionable, or against public policy. As the Montana Supreme Court stated in *Iwen*, "[One party] pointedly protected itself by preserving its constitutional right of access to the judicial

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[4] Addendum No. 1 is included within Addendum No. 2. The Court notes that the addendum does not impose any new obligations on Choice. It imposes many new obligations on the Ticknors, and Choice agrees to a 3-year rather than 5-year multiplier in the calculation of its liquidated damages in the event of the Ticknors' untimely termination.

system while at the same time [it] completely removed that right from the [other]." *Id.* at ¶ 31, 977 P.2d at 996. "Drafted as such, the weaker bargaining party has no choice but to settle all claims arising out of the contract through final and binding arbitration, whereas the more powerful bargaining party and drafter has the unilateral right to settle a dispute for collection of fees pursuant to the agreement in a court of law." *Id.* at ¶ 31, 977 P.2d at 995. The arbitration clause in *Iwen* was unconscionable.

So is the clause in Choice's contract. In addition to reserving the right of access to the courts and to juries for itself alone, Choice requires its franchisees to travel to Maryland, a hardship that a court of law could not impose because of the due process requirements for personal jurisdiction.

III. Conclusion

The arbitration clause in this Agreement is inequitable. Whether it lacks consideration under Maryland law or is unconscionable under Montana law, Choice cannot enforce it against the Ticknors.

Accordingly, Defendant Choice Hotels' motion to dismiss or, in the alternative, to compel arbitration (dkt # 2) is DENIED. Plaintiff Ticknors' motion for a preliminary injunction (dkt # 5) is DENIED AS MOOT. The arbitration clause is unenforceable under the facts of this case. A preliminary pretrial scheduling order accompanies this Order.

DATED this 6th day of December, 1999.

/s/ Donald W. Molloy
DONALD W. MOLLOY
UNITED STATES DISTRICT
JUDGE

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1 – GENERAL PROVISIONS

§ 1. "Maritime transactions" and "commerce" defined; exceptions to operation of title

"Maritime transactions", as herein defined, means charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction; "commerce", as herein defined, means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1 – GENERAL PROVISIONS

§ 2. Validity, irrevocability and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to

settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1 – GENERAL PROVISIONS

§ 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1 – GENERAL PROVISIONS

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and

determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

UNITED STATES CODE ANNOTATED
TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART IV – JURISDICTION AND VENUE
CHAPTER 89 – DISTRICT COURTS; REMOVAL OF CASES FROM STATE COURTS

§ 1441. Actions removable generally

(a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending. For purposes of removal under this chapter, the citizenship of defendants sued under fictitious names shall be disregarded.

(b) Any civil action of which the district courts have original jurisdiction founded on a claim or right arising under the Constitution, treaties or laws of the United States shall be removable without regard to the citizenship or residence of the parties. Any other such action shall be removable only if none of the parties in interest properly joined and served as defendants is a citizen of the State in which such action is brought.

(c) Whenever a separate and independent claim or cause of action within the jurisdiction conferred by section 1331 of this title is joined with one or more otherwise non-removable claims or causes of action, the entire case may be removed and the district court may determine all issues therein, or, in its discretion, may remand all matters in which State law predominates.

(d) Any civil action brought in a State court against a foreign state as defined in section 1603(a) of this title may be removed by the foreign state to the district court of the United States for the district and division embracing the place where such action is pending. Upon removal the action shall be tried by the court without jury. Where removal is based upon this subsection, the time limitations of section 1446(b) of this chapter may be enlarged at any time for cause shown.

(e) The court to which such civil action is removed is not precluded from hearing and determining any claim in such civil action because the State court from which such civil action is removed did not have jurisdiction over that claim.

Mont. Code Ann. § 27-5-323. Venue. An initial application must be made to the court of the county in which the agreement provides the arbitration hearing must be held or, if the hearing has been held, in the county in which it was held. Otherwise, the application must be made in the county where the adverse party resides or has a place of business or, if he has no residence or place of business in this state, to the court of any county. All subsequent applications must be made to the court hearing the initial application unless the court otherwise directs. No agreement concerning venue involving a resident of this state is valid unless the agreement requires that arbitration occur within the state of Montana. This requirement may only be waived upon the advice of counsel as evidenced by counsel's signature thereto.

Mont. Code Ann. § 28-2-708. Restraints upon legal proceedings void. Every stipulation or condition in a contract by which any party thereto is restricted from enforcing his rights under the contract by the usual proceedings in the ordinary tribunals or which limits the time within which he may thus enforce his rights is void. This section does not affect the validity of an agreement enforceable under Title 27, chapter 5.

Applicable Contract Provisions

20. Severability and Construction

a. If any section of the agreement is held to be illegal, invalid or unenforceable, both parties agree that (1) the section will be removed; (2) this Agreement will be understood and enforced as if the illegal, invalid, or unenforceable section had never been in this Agreement; and (3) the remaining sections will remain in full force and effect and will not be affected by the illegal, invalid, or unenforceable section or by its removal. A section similar to the removed section will be automatically added as a part of this Agreement to the maximum extent enforceable.

* * *

f. This Agreement becomes valid only when we have signed it, and it will be interpreted under the substantive laws of Maryland, not including its conflict of laws provision.

* * *

h. Each party may obtain injunctive relief against threatened conduct that will cause it loss or damages, under the usual equity rules, including the applicable rules for obtaining restraining orders and preliminary injunctions.

Supreme Court, U.S.
FILED
JAN 16 2002
CLERK

No. 01-888

In The

Supreme Court of the United States

CHOICE HOTELS INTERNATIONAL, INC.,

Petitioner,

v.

JAMES L. TICKNOR; JANET TICKNOR; LARRY TICKNOR; TICKCO HOLDING, L.L.C., AND TICKNOR LODGING CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the Ninth Circuit Court of Appeals erred when it held that, under the law of the State of Montana, the arbitration clause in the franchise agreement between the parties was unconscionable.

2. Whether the Federal Arbitration Act (9 U.S.C. § 1 *et seq.*) preempts application of Montana law concerning the unconscionability of the arbitration clause contained in the franchise agreement.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, respondents Tickco Holding, LLC and Ticknor Lodging Corporation, through counsel, state that they have no parent corporations, and that no publicly-held company owns 10% or more of its stock (Ticknor Lodging Corporation) or membership interests (Tickco Holding, LLC).

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OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondents James L. Ticknor, Janet Ticknor, Larry Ticknor, Tickco Holding, L.L.C., and Ticknor Lodging Corporation (collectively "Ticknors") respectfully oppose the petition for a writ of certiorari requested by Choice Hotels International, Inc.

STATEMENT OF JURISDICTION

Certiorari is not appropriate because the Ninth Circuit's decision does not conflict with an applicable decision of this Court or of any other Circuit Court of Appeals.

STATEMENT OF THE CASE

A. FACTS

Respondents James Ticknor and Ticknor Lodging Corporation signed a franchise agreement with Choice Hotels International, Inc., in 1998. Petition, App., p. 2. Under the agreement, the Ticknors were to pay franchise fees, and Choice was to allow them to use the Econo-Lodge mark and provide certain assistance. *Id.* The other respondents, Janet and Larry Ticknor and Tickco Holding, L.L.C., signed a separate guarantee. *Id.* There were 2 addenda to the franchise agreement. *Id.*, p. 4. The franchise agreement and the addenda were generated by Choice, and the Ticknors were "forced to accept or reject without negotiation." *Id.*, p. 12.

The franchise agreement contains an arbitration clause providing that arbitration would occur at Choice's "headquarters office in Maryland." *Id.*, p. 3. The arbitration clause required all of the Ticknors' claims to be arbitrated, but excepted from its scope any claims that Choice may have against the Ticknors for "indemnification, actions for collections of moneys owed us under the Agreement, or action seeking to enjoin you . . . " *Id.* The guarantee agreement contained no arbitration clause. *Id.*, pp. 4-5.

Disagreements arose between the parties concerning Choice's performance or non-performance and the Ticknors suspended payment of the franchise fees. *Id.*, p. 4. Choice then commenced arbitration proceedings. *Id.*, p. 4. The claims which Choice sought to arbitrate were for "fees, service charges and damages for lost profits pursuant to a franchise agreement." Exhibit 6 to Sept. 15, 1999 hearing, admitted at transcript p. 4. The franchise agreement's arbitration clause, of course, had excepted from arbitration all of Choice's claims against Ticknors for "moneys owed us under the Agreement."

Facing arbitration in Choice's corporate headquarters of claims which they had never agreed to arbitrate, the Ticknors brought this action. Petition, App., pp. 4-5. In their complaint, the Ticknors pled not only that the arbitration clause did not require arbitration of Choice's claims, but also that the arbitration clause was invalid as unconscionable. *See* Amended Complaint.

Choice moved to compel arbitration and, after an evidentiary hearing, the District Court denied it on the grounds that the arbitration clause was unconscionable

and therefore unenforceable. *Id.*, p. 5. The Ninth Circuit affirmed. *Id.*, p. 17.

B. THE NINTH CIRCUIT DECISION

Choice portrays this case as having great significance. To the contrary, this case concerns an extremely narrow issue of state law: Given the facts of the case, is the agreement to arbitrate invalid as unconscionable under the law of the state of Montana? This is evident from the Ninth Circuit opinion itself. The Ninth Circuit noted that the Ticknors had raised "the state law defense of unconscionability . . . " Petition, App., p. 7. The Ninth Circuit then applied Montana's choice of law analysis (Petition, App., pp. 7-9), and Montana law regarding unconscionability (Petition, App., pp. 11-15). The Ninth Circuit then held that the district court had not erred in finding that the arbitration clause "was unenforceable as unconscionable under Montana law . . . " Petition, App., p. 17.

The only other issue is preemption: whether the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* ("FAA") preempts application of that Montana law. As is shown below, this Court has declared, on numerous occasions, that such state law principles of general applicability may be applied, and are not preempted by the FAA. Montana's law of unconscionability is such a generally applicable principle. Thus, there is no conflict with the decisions of this Court.

C. STATUTORY FRAMEWORK

Congress enacted the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1-16 (1999), to overcome judicial hesitation to enforce arbitration agreements. *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 478 (1989). The FAA does not require arbitration; only that courts enforce valid agreements to arbitrate. *Volt*, 489 U.S. at 478.

Thus, § 2 of the FAA merely provides that an agreement to arbitrate is enforceable just as any other agreement, and subject to the same defenses which would support the revocation of any other agreement.

> A written provision . . . to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2.

Because arbitration agreements are enforceable, a party may obtain a stay of a legal action over an issue which the parties agreed to arbitrate. The FAA does not, however, make issues arbitrable absent a binding agreement to arbitrate.

> If any suit or proceeding be brought in any of the courts of the United States *upon any issue referable to arbitration under an agreement* in writing for such arbitration, the court in which such suit is pending, *upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement*, shall on

> application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement.

9 U.S.C. § 3 (emphasis added).

Besides staying litigation over issues that the parties agreed to arbitrate, the court can force the party to arbitrate, but only if the court is satisfied that a binding agreement to arbitrate exists. Thus, a party aggrieved by the failure of another to arbitrate "under a written agreement for arbitration" may petition a court to compel arbitration.

> The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default . . . the court shall hear and determine such issue.

9 U.S.C. § 4. The remainder of section 4 provides for a jury trial, if requested, on the making of the agreement to arbitrate, and requires dismissal of the petition to compel arbitration if the jury finds no agreement. *Id.*

Thus, under the FAA, because the Ticknors contested the validity of the arbitration agreement, it was the duty of the district court summarily to try and decide that issue. That is what happened. The district court held an evidentiary hearing (Petition, App., p. 5), and decided

that, under the facts of this case, the arbitration clause was unenforceable. *See generally* Petition, App., pp. 23-34.

In doing so, the district court applied Montana state law regarding unconscionable contracts. Petition, App., pp. 29-33. The Ninth Circuit did likewise. Petition, App., pp. 11-15. This is entirely consistent with federal law.

Section 2 of the FAA states that arbitration agreements are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." The source of that law is obviously state law. Indeed, this Court has declared on numerous occasions that state contract principles may be applied.

> States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of any contract."

Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 281 (1995). Yet again, in *Casarotto*, this Court stated:

> Repeating our observation in *Perry*, the text of § 2 declares that state law may be applied "if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2.

Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681, 686-87 (1996). *See also Perry v. Thomas*, 482 U.S. 483, 492, n.9 (1987). Thus, this Court has clearly stated that state law principles of unconscionability may be applied "without

contravening" the FAA. That is what the lower courts did.

ARGUMENT

I. THERE IS NO SPLIT AMONG THE CIRCUITS.

Choice attempts to demonstrate a conflict between the Ninth Circuit and other Courts of Appeals by citing cases from other circuits which refused to invalidate arbitration clauses on the grounds of a lack of mutuality of obligation. Petition, pp. 21-23. The resulting "conflict" is an illusion. In fact, the cases cited by Choice, like the Ninth Circuit, applied state law of general applicability. Some of them reached different results, not because of any conflict about the rule of law to be applied, but because they considered different arbitration clauses, under different sets of facts, in light of different arguments, and applying the law of different states.

The Ninth Circuit did not find the arbitration clause at issue to be unenforceable solely on the basis of a lack of mutuality of obligation. It found it to be unconscionable because it was, *inter alia*, "unreasonably favorable to the drafter." Petition, App., p. 14. Indeed, the Ninth Circuit specifically recognized that, under Montana law, "[t]here is no requirement that . . . 'arbitration agreements must contain mutual promises that give parties identical rights and obligations or that the parties must be bound in the exact same manner.' " Petition, App., pp. 13-14, *quoting Iwen v. U.S. West Direct*, 293 Mont. 512, 977 P.2d 989, 996 (1999). The Ninth Circuit understood that,

rather than requiring exact mutuality, Montana law simply inquires as to whether the disparities are so one sided and unreasonably favorable to the drafter so as to be oppressive and unconscionable. *Id.*, p. 14. The Ninth Circuit thus did not decide the case based upon a lack of mutuality of obligation, and it avails nothing to try to compare its decision to cases which did.

That different courts have reached different results on the issue of unconscionability of a particular clause in a particular fact situation would hardly be surprising, given that it is a fact intensive question of state law. The unconscionability analysis is a question of state law. *See Casarotto, supra.* The Ninth Circuit in this case applied Montana law. None of the cases cited by Choice applied Montana law. *See, e.g., Johnson v. Circuit City Stores, Inc.*, 148 F.3d 373, 376 (4th Cir. 1998), *cert. denied*, 530 U.S. 1276 (2000) (applying Maryland law); *Harris v. Green Tree Financial Corp.*, 183 F.3d 173, 181 (3rd Cir. 1999) (Pennsylvania law); and *Michalski v. Circuit City Stores, Inc.*, 177 F.3d 634, 637 (7th Cir. 1999) (Wisconsin law). To the extent the law varies from one state to another, different results may be expected, particularly given the fact intensive nature of the inquiry.

Further, the entire analysis is highly dependent upon the facts of each case. *See, e.g., Zalewski v. Simpson*, 435 N.E.2d 74, 78 (Ind. App. 1982) ("[i]t is impossible to lay down any definite rules as to what may or may not be unconscionable, for each case must depend upon its own particular facts"); *Wilkerson v. Wilkerson*, 555 S.W.2d 689, 691 (Mo. App. 1977) (whether a property settlement is

unconscionable is a question which "depends on the particular facts of each individual case"); *220 West 42 Associates v. Ronbet Newmark Co.*, 84 Misc.2d 259, 263, 375 N.Y.S.2d 255, 260 (1975).

A review of the cases cited by Choice reveals no direct conflict. *O'Neil v. Hilton Head Hospital*, 115 F.3d 272 (4th Cir. 1997) did not even address an argument that the arbitration agreement was unconscionable. Instead, the argument was a lack of consideration because the hospital was supposedly not bound by the arbitration. *O'Neil*, 115 F.3d at 274. *O'Neil* did not even consider an argument of unconscionability. Likewise, in *Johnson*, the district court invalidated an arbitration clause in an employment application for lack of consideration, reasoning that the employer had not incurred a detriment because it had not affirmatively agreed to consider the application if the applicant agreed to the arbitration clause. *Johnson*, 148 F.3d at 377. The Fourth Circuit relied upon *O'Neil* to hold that both parties were bound by the arbitration clause, and therefore consideration existed. *Johnson*, 148 F.3d at 378. Once again, the court did not apply any unconscionability analysis. Indeed, there is no suggestion that the applicant even raised the argument that the agreement was unconscionable. Similarly, in *Michalski*, the court considered an argument of lack of consideration, not unconscionability. *Kroll v. Doctor's Associates, Inc.*, 3 F.3d 1167, 1171 (7th Cir. 1993) is even more removed, involving a case in which the parties were both "mutually obligated to arbitrate all disputes." *Kroll*, 3 F.3d at 1171. It has nothing in common with the Ninth Circuit opinion, and certainly does not conflict. In fact,

none of these cases conflict with the Ninth Circuit opinion because the litigants therein did not even raise an unconscionability argument.

Harris considered claims that an arbitration clause in a loan document lacked mutuality and was unconscionable. Applying Pennsylvania law (183 F.3d at 181-82), the Third Circuit held that the agreement was not unenforceable for lack of mutuality. *Harris*, 183 F.3d at 179-182. When it reached the issue of substantive unconscionability (distinguished from procedural unconscionability due to the arbitration agreement appearing in fine print on the reverse of the contract), the court simply referenced its earlier holding about the lack of mutuality. *Harris*, 183 F.3d at 183. There is scant independent analysis on that issue, and no suggestion that the applicable (Pennsylvania) law would invalidate a contract on those grounds. Nor did *Harris* involve arbitration in the drafter's corporate offices, another factor supporting a finding of unconscionability in this case. In short, *Harris* involved a different agreement, different facts, and the law of a different state. It does not conflict with the Ninth Circuit opinion.

Consistent with the Ninth Circuit, these cases recognized that state law defenses can apply. There is no split among the circuits on that rule of law. Most of them did not even address an argument that the agreement was unconscionable. They may have, under different facts and law, and in light of different arguments, reached a different result. The conflict, if any, is a conflict among the law of different states, and not appropriate for resolution by this Court.

II. THE NINTH CIRCUIT OPINION DOES NOT CONFLICT WITH ANY DECISIONS OF THIS COURT.

A. THE NINTH CIRCUIT OPINION DOES NOT CONFLICT WITH *ERIE* OR *KLAXON*.

In its Argument I (Petition, pp. 14-17), Choice argues that the method in which the Ninth Circuit applied Montana law violates the principles of *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938) and *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487 (1941) because the Court concluded that Montana law would apply the principle of unconscionability, even in the context of a contract between business persons. Thus, according to Choice, the Ninth Circuit decision conflicts with *Erie* and *Klaxon*, requiring review by this Court.

While Choice dresses this argument as a violation of the doctrines of *Erie* and *Klaxon*, the argument is, at bottom, simply that the Ninth Circuit reached an incorrect result while applying Montana law. Notably, Choice does not argue that Montana law should not have been applied. The rules of *Erie* and *Klaxon* require the Ninth Circuit to apply Montana law. Indeed, the pronouncements of this Court leave no doubt that state law principles of unconscionability apply. *See* discussion, *supra*, p. 6. The Ninth Circuit properly understood that it must apply state law. Choice simply argues that the result was wrong, and asks this Court to correct the asserted error. Under Rule 10, Supreme Court Rules, this is not a basis for granting certiorari.

More fundamentally, however, Choice's argument misunderstands the duty of a federal court to apply state

law when sitting in diversity. Choice recognizes that the district court, sitting in diversity, was bound by *Erie* to apply Montana law. Petition, p. 15.[1] Choice argues, however, that the district court and the Ninth Circuit incorrectly applied Montana law because, absent a Montana decision directly on point, the lower courts were prohibited from "speculating as to which line of cases Montana courts would ultimately adopt." Petition, p. 17. Thus, Choice's argument is that the Ninth Circuit improperly divined Montana law on an issue not directly addressed by the Montana courts, *i.e.*, would an unconscionability analysis apply even in a contract between businessmen. Choice's argument does not state a ground for granting certiorari because the Ninth Circuit was bound to do precisely what it did, *i.e.*, to decide how the state's highest court would decide that issue. Further, this Court will not disturb the Ninth Circuit's determination of that question because it is supported by Montana law.

When sitting in diversity and therefore applying the law of the forum state, a federal court may be faced with unsettled questions of state law. If so, "the federal court must decide how the state's highest court would decide the issue." 17A *Moore's Federal Practice*, § 120.31[1][b][iii] (Matthew Bender 3d ed. 2001). *See also Comm'r v. Bosch*, 387 U.S. 456, 465 (1967) (absent controlling precedent by highest state court, federal courts "must apply what they find to be the state law . . . "). Federal courts have a duty to apply state law even where that state law is "uncertain

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[1] In spite of that concession, Choice later, in an aside, suggests that "it was improper for the Ninth Circuit to apply Montana law . . . in the first instance." Petition, p. 16.

or difficult to determine." *Meredith v. City of Winter Haven*, 320 U.S. 228, 236 (1943). In such a case, this Court has answered questions of state law, "although the highest court of the state had not answered them," "with the aid of such light as was afforded by the materials for decision at hand, and in accordance with the applicable principles for determining state law." *Meredith*, 320 U.S. at 237. Clearly, the Ninth Circuit correctly discerned that it was bound to determine how the highest court of Montana would decide an issue of state law which was not addressed in existing precedent. Petition, App., p. 11. In other words, even if the Ninth Circuit had erred in its application, it was a "properly stated rule of law" which is "rarely" a basis for granting certiorari.

Where lower federal courts have decided an unsettled question of state law in a manner that is supported by "reasonable arguments", this Court's "general policy" is to "leave undisturbed" the Court of Appeals' holding on state law. *Spiegel's Estate v. Comm'r*, 335 U.S. 701, 708 (1949). *Spiegel's Estate* noted that the circuit judges were constantly required to apply the law of the state in question. 335 U.S. at 707. Further, examination of the state law had left this Court "unable to say with any degree of certainty that the Court of Appeals' holding was wrong." 335 U.S. at 708. The same applies in this case. The Ninth Circuit is often called upon to apply Montana law. Further, there are reasonable arguments supporting the Ninth Circuit's conclusion that the Montana Supreme Court would apply an unconscionability analysis even in the context of a contract between businessmen.

The crux of Choice's argument is that Montana law, and notably *Iwen v. U.S. West Direct*, 293 Mont. 512, 977

P.2d 989 (1999), do not apply the unconscionability test to contracts between businessmen. Petition, pp. 14-17. However, *Iwen* involved an attorney who purchased an advertisement for his law office. *Iwen*, 977 P.2d at 991. It is a "reasonable argument" that Mr. Iwen was as much a businessman as James Ticknor, and that the same analysis would apply. Further, the test for unconscionability, as framed by *Iwen*, does not require that one of the parties be a consumer as opposed to a businessman. *Iwen*, 977 P.2d at 995.

The test focuses, initially, on disparity of bargaining power. *Id.* The record in this case contains financial information concerning the parties, showing: Choice with total assets of more than $445 million and annual revenues of $140 million (*see* Exhibit 5 to Sept. 15, 1999 hearing, pp. 1-4, admitted at transcript p. 4); Mr. Ticknor with a net worth of $684,412 (Exhibit 12, admitted at transcript, p. 4); and the other franchisee, Ticknor Lodging Corp., with total assets of $14,305 (Exhibit 13, admitted at transcript, p. 4) and annual gross revenues of $344,650 (Exhibit 14, admitted at transcript, p. 4).

Finally, the Ninth Circuit also relied upon *In re: Michael's Estate*, 264 Mont. 261, 266, 871 P.2d 272, 275 (1994), in which the Montana Supreme Court had stated the "indicia of unconscionability relating to a [contract] between two business professionals." The Montana Supreme Court, far from ruling out application of the doctrine of unconscionability in contracts between business people, had spelled out the test for such an analysis. Thus, the Ninth Circuit did not err when it concluded that, under Montana law, the test applied even between business people.

In light of all of the foregoing, "reasonable arguments" exist in favor of the Ninth Circuit's construction of Montana law, and this Court cannot conclude "with any degree of certainty" that such determination was wrong. *See Spiegel's Estate, supra.* While Choice disagrees with the result, it is plain that the Ninth Circuit did not violate the doctrines of *Erie, Klaxon,* or any other federal principle. Choice asks this Court to correct alleged error (that Montana would apply an unconscionability analysis to contracts between business persons) which is not even erroneous.

Finally, Choice faults the Ninth Circuit for "ignor[ing]" other Montana cases, notably *All-States Leasing Co. v. Top Hat Lounge, Inc.*, 198 Mont. 1, 649 P.2d 1250 (1982). Choice, however, never cited either *All-States,* or any similar case, for the proposition which it now urges. This Court should not grant certiorari to review an argument which the Ninth Circuit had no opportunity to address.

B. THE DECISION OF THE NINTH CIRCUIT DOES NOT CONFLICT WITH *CASAROTTO.*

Choice argues that, by invalidating the arbitration agreement based upon state law, the Ninth Circuit violated the standards enunciated in *Doctor's Associates, Inc. v. Casarotto,* 517 U.S. 681 (1996). Petition, pp. 17-21. According to Choice, the unconscionability analysis contained in Montana law which the Ninth Circuit applied to invalidate the arbitration provision, singles out arbitration agreements and therefore is preempted. *See* Petition, App., pp. 17-21. To the contrary, the Ninth Circuit did not

run afoul of *Casarotto*, or any other pronouncements by this Court, in applying state law on the question of the unconscionability of the arbitration provision.

Casarotto specifically stated that "generally applicable contract defenses, such as . . . unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Casarotto*, 517 U.S. at 686-87. Unlike *Casarotto*, which involved a state statute requiring a notice, in certain size type, on the front of any contract containing an arbitration clause, this case involves a standard contract defense of general applicability.

Perhaps recognizing that state law does apply, Choice attempts to argue that the Ninth Circuit misapplied that law by failing to recognize that Montana law does not inquire into the adequacy of consideration. Petition, App., pp. 18-19. This argument, once again, is simply that there has been a misapplication of a properly stated rule of law. Such error correction is not a basis for granting certiorari. More fundamentally, however, it misunderstands what the Ninth Circuit held. The Ninth Circuit did not hold that, under Montana law, the arbitration provision was void for lack of consideration. It held that it was void as unconscionable. Petition, App., p. 17. Certainly, the fact that Choice reserved the right to sue on its monetary claims, but the Ticknors had to arbitrate their claims, was relevant to that inquiry. *Kelly v. Widner*, 236 Mont. 523, 528, 771 P.2d 142, 145 (1989) (stating in the context of a release of claims for personal injury, that "[i]nadequacy of consideration does not by itself invalidate a bargain, but may be a factor in determining conscionability"). However, the basis for the Ninth Circuit's holding was not simply failure of consideration, but

unconscionability of the arrangement as a whole, including the requirement that arbitration occur in Choice's headquarters office.

Choice next argues that the *Iwen* unconscionability analysis is preempted because it singles out arbitration clauses. Thus, Choice argues that Montana law is "hostile to, or applicable only to, agreements to arbitrate." Petition, p. 20. The Ninth Circuit found otherwise, specifically noting that, under Montana law, the principles of *Iwen* were "general principles that exist at law or in equity for the revocation of any contract." Petition, App., p. 16. Moreover, the Ninth Circuit has since demonstrated that it understands full well the difference between generally applicable contract defenses, and those which would serve only to invalidate an arbitration clause. *See Bradley v. Harris Research, Inc.*, 2001 WL 1658728 (9th Cir., December 28, 2001), at 5, n. 7.

A review of Montana cases demonstrates that the Ninth Circuit was correct in finding the unconscionability analysis to be applicable to contracts generally, and not to single out arbitration clauses. First, the unconscionability analysis has long been applied in varied contexts. *See, e.g., Wilkes v. Estate of Wilkes*, 305 Mont. 335, 27 P.3d 433 (2001) (prenuptial agreement); *In re Marriage of Pearson*, 291 Mont. 101, 965 P.2d 268 (1998) (settlement agreement in divorce); *Kelly v. Widner*, 236 Mont. 523, 771 P.2d 142 (1989) (release of claims for personal injury); *Eigeman v. Miller*, 229 Mont. 28, 745 P.2d 320 (1987) (provisions of an installment land contract); *Beneficial Commercial Corp. v. Cottrell*, 212 Mont. 493, 688 P.2d 1254 (1984) (limitation of remedies in equipment lease). The principle of

unconscionability is a well known, and oft-applied, contract defense. Its application does not "single out" arbitration agreements, and is therefore not preempted.

Second, the Montana Supreme Court has upheld arbitration clauses in the face of arguments of unconscionability. *See Chor v. Piper, Jaffray & Hopwood, Inc.*, 261 Mont. 143, 149, 862 P.2d 26, 30 (1993) (reversing trial court's decision invalidating arbitration clause, and explaining that "an arbitration clause may be enforced even if the agreement in which the clause appears is an adhesion contract, absent evidence that the arbitration clause was not within the parties' reasonable expectations or that the clause is oppressive or unconscionable"); *Passage v. Prudential-Bache Securities, Inc.*, 223 Mont. 60, 727 P.2d 1298 (1986). The cases simply do not demonstrate any hostility to arbitration clauses *per se*. Instead, as permitted under *Casarotto*, under Montana law the concept of unconscionability is applicable to contracts generally, and does not invalidate even arbitration clauses absent the same factors which must be found to invalidate any other contract.

Unlike *Casarotto*, this case does not involve a statute or principle which applies only to arbitration clauses. It involves, instead, a state law principle which is applicable to contracts generally. Indeed, it involved a defense which this Court has specifically enumerated as a permissible state law contract defense.

In short, this Court has specifically recognized that state law principles, such as unconscionability, may be applied to invalidate arbitration agreements without running afoul of § 2 of the FAA. That is what the Ninth

Circuit did. Choice argues that this is a wrong result, but there can be no question that the rule of law was properly stated. Accordingly, this is not a ground to grant certiorari.

III. CHOICE'S "REASONS FOR GRANTING THE WRIT" STATE, AT MOST, ALLEGEDLY ERRONEOUS FACTUAL FINDINGS OR MISAPPLICATION OF A PROPERLY STATED RULE OF LAW.

Supreme Court Rule 10 states that "certiorari is rarely granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law." Choice's petition complains not about the rules of law applied by the Ninth Circuit, but only about the result it reached. In other words, Choice asserts erroneous factual findings and misapplication of a properly stated rule of law.

For instance, Choice complains about alleged inaccuracies in the factual findings of both the trial court and the Ninth Circuit. Petition, p. 8. *See also id*, p. 10, n. 4. Both passages argue about the accuracy of the lower courts' application of the choice of law analysis. Choice does not attempt to argue, however, that the Ninth Circuit applied the wrong analysis altogether. Indeed, Choice conceded in its Ninth Circuit briefs that "a federal court sitting in diversity must look to the law of the forum state in making a choice of law determination" and that "Montana courts apply the Restatement (Second) of Conflict of Laws, § 187 (2) in resolving the question. . . . " Choice's Ninth Circuit opening brief, p. 17; Choice's Ninth Circuit reply brief, p. 10. That is precisely the

analysis which the Ninth Circuit applied. Petition, App., pp. 7-9. Thus, Choice argues only that the Ninth Circuit reached an incorrect result while applying the correct rule of law. Such alleged error is not within Sup. Ct. Rule 10, nor worthy of this Court's attention.

Similarly, Choice's Argument I (Petition, pp. 14-17) argues that the Ninth Circuit reached an incorrect result in applying Montana's test for the unconscionability of a contractual provision. Choice argues that the Ninth Circuit misunderstood, and therefore misapplied, Montana law. For instance, it argues that the Ninth Circuit "ignored the facts" of controlling Montana precedent, and ignored other Montana case law. Petition, App., p. 15. Thus, according to Choice, the Ninth Circuit improperly extended the holding of the controlling Montana case, and failed to properly "apply the law of Montana as it existed . . . " Petition, App., p. 16. Accordingly, Choice concludes that "the Ninth Circuit ignored [the controlling principles of state law] and instead relied upon inapplicable precedents . . . " Petition, App., p. 17.

Further, as discussed *supra*, while Choice tries to demonstrate a conflict with *Erie*, its argument is essentially that, while obligated to apply state law, the Ninth Circuit misapplied that law. Once again, Choice is asking this Court to correct alleged error in applying a properly stated rule of law.

Finally, even the error which Choice does claim is illusory. The Ninth Circuit properly applied state law.

CONCLUSION

The Ninth Circuit opinion conflicts with neither decisions of this Court nor decisions by other Circuit Courts of Appeals. The issue is both fact intensive and state law dependent, and not appropriate for consideration by this Court.

Respectfully submitted,

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(3)

Supreme Court, U.S.
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No. 01-888

IN THE

Supreme Court of the United States

CHOICE HOTELS INTERNATIONAL, INC.,

Petitioner,

v.

JAMES L. TICKNOR; JANET TICKNOR; LARRY TICKNOR; TICKCO HOLDING, L.L.C.; AND TICKNOR LODGING CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF *AMICUS CURIAE* NATIONAL FRANCHISE COUNCIL IN SUPPORT OF PETITIONER

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INTEREST OF THE AMICUS CURIAE[1]

The future of franchising — which today accounts for upwards of fifty percent (50%) of all retail sales transacted in the United States and which *per force* relies on uniform contracts to achieve uniform franchise unit appearance and operations — will be placed in grave peril if the decision of the Ninth Circuit sought to be reviewed herein is not, following such review, reversed as a matter of law. So, too, will the Lanham Act (15 U.S.C. §§ 1051 *et seq.*) and Federal Arbitration Act (9 U.S.C. §§ 1 *et seq.*) be stripped of their intent.

Thus, the National Franchise Council (a Washington, D.C. not-for-profit corporation) respectfully submits this *amicus curiae* brief in support of Petitioner Choice Hotels International, Inc.'s petition for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit.

The National Franchise Council is a not-for-profit corporation whose membership is restricted to our nation's largest and most reputable franchisors, as identified below. The National Franchise Council is dedicated to fostering a legal and regulatory environment favorable to franchising's continued growth and success. This goal is achieved in part through the National Franchise Council's alternative law enforcement program, which has been adopted on a trial basis

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1. Pursuant to United States Supreme Court Rule 37.3(a), counsel of record has filed letters with the Clerk of Court consenting to the filing of this brief. Pursuant to Rule 37.6, counsel for *amicus* states that no counsel for a party authored this brief in whole or in part and no person, other than amicus, its members, or its counsel made a monetary contribution to the preparation or submission of this brief.

by the Federal Trade Commission (which regulates franchising for the federal government) and by certain states administering franchise-specific statutes.

The National Franchise Council's members[2] own and administer the following franchise networks:

AmeriHost Inns	Inter-Continental Hotels
AmeriSpec Home Inspection	Jackson Hewitt Tax Service
Arby's Restaurants	KFC
Avis Car Rental	MainStay Suites
Baskin-Robbins Ice Cream	Merry Maids
CENTURY 21 Real Estate	Pizza Hut
Churchs Chicken	Popeyes Chicken & Biscuit
Cinnabon	Quality Inns
Clarion Hotels	Ramada Hotels
Coldwell Banker Real Estate	Rodeway Inns
Comfort Inns	Seattle Coffee Company
Crowne Plaza Hotels	ServiceMasterClean
Days Inns	Sheraton Hotels
Doubletree Hotels	Sleep Inns
Dunkin' Donuts	St. Regis Hotels
Econo Lodge Hotels	Super 8 Motels
Embassy Suites Hotels	T.J. Cinnamons
	Taco Bell
	Terminix

2. *AFC Enterprises, Inc.; Allied Domecq QSR, Inc; Cendant Corporation; Choice Hotels International, Inc.; Hilton Hotels Corporation; Marriott International, Inc.; Medicine Shoppe International, Inc. Meineke Discount Muffler Shops, Inc.; Midas International, Inc.; Pearle Vision, Inc.; The ServiceMaster Company; 7-Eleven, Inc.; Six Continents Hotels, Inc.; Starwood Hotels & Resorts Worldwide, Inc.; Triarc Restaurant Group; and, Tricon Global Restaurants, Inc.*

ERA Real Estate	Togo's
Four Points Hotels	Torrefazione Italia
Furniture Medic	Restaurants
Hampton Inns	Travelodge Hotels
Hilton Hotels	TruGreen-ChemLawn
Holiday Inns	Westin Hotels
Homewood Suites	
Howard Johnson Hotels	

SUMMARY OF ARGUMENT

Amicus curiae National Franchise Council (an organization whose membership is restricted to the nation's largest and most reputable franchisors) respectfully submits that the Ninth Circuit Court of Appeals grievously erred when it held that the arbitration clause contained in Respondent Ticknor's Choice Hotels franchise agreement was a "contract of adhesion," unenforceable due to its purported "unconscionability."

The Choice Hotels franchise agreement which Respondent Ticknor executed was deliberately pursued by Respondent Ticknor, and thereafter executed by him, to the exclusion of thirty-one (31) alternative franchise relationships which he chose to spurn. Unlike the factual setting in *Iwen* (cited and quoted below) — the Montana Supreme Court decision almost exclusively relied on by the Ninth Circuit in rendering its decision *sub judice* — there was no marketplace or any other compulsion attending Ticknor's entry into his franchise agreement, only Ticknor's desire to execute same. He could have remained an "independent," unaffiliated hotel owner, but instead pursued a franchise relationship. Respondent Ticknor could have selected another of the thirty one alternative hotel franchises available to him, but he pursued Choice Hotels. Now, Respondent Ticknor complains

that the very contract be pursued, wanted and obtained — the contract he executed absent any compulsory circumstance — is adhesive and unconscionable. Such a conclusion has no support at law, and the Ninth Circuit erred when it held otherwise.

True it is that Ticknor's franchise agreement was largely non-negotiable. But that does not *ipso facto* render it a "contract of adhesion." Franchising — which in the past fifty years has grown so exponentially that today it accounts for nearly 50% of all retail sales consummated in the United States — has as its bedrock the need to respond to the public's desire, indeed demand, for complete franchise unit uniformity. To meet this consumer demand, each unit in virtually every franchise network must operate under the same name and commercial symbol; sell the same products or services; and, have the same appearance and trade dress. It is this very operational uniformity that the Lanham Act not only anticipates but demands, uniformity which maintains the value of a franchisor's trademark and service mark while promoting consumer welfare by meeting consumer expectations.

Only through identical franchise agreements can a franchisor achieve such franchise unit uniformity. But the fact that any given network's franchise agreements are uniform and frequently non-negotiable does not render them "contracts of adhesion" because franchisees, like Respondent Ticknor, have a universe of franchise alternatives to select from (Ticknor had thirty one) and thus confront no compulsory contractual setting. As a matter of law, when one contract is selected to the exclusion of many others available, and when no contract at all is necessary to begin with (Ticknor

could have operated as an "independent," like so many others), no "contract of adhesion" may result — even when the contract selected is non-negotiable.

Further, it is impossible to contend that the subject arbitration clause was "unconscionable" because it was not within Respondent Ticknor's "reasonable expectation" — which may explain why the Ninth Circuit utterly ignored this second prong of Montana's two prong "unconscionability" test when rendering its decision. Pursuant to federal and state law (as cited and discussed below), Ticknor received full and complete advance disclosure in narrative form regarding each and every aspect of the subject Choice Hotels franchise agreement — including the arbitration clause at issue herein. Also by operation of law, Ticknor was required to delay executing his Choice Hotels franchise agreement until five business days elapsed from the time he received it, to give him an opportunity to fully discern each and every provision thereof. It was only after such full disclosure was effected and the five business day "waiting period" had elapsed that Respondent Ticknor deliberately elected to execute his Choice Hotels franchise agreement.

Finally, the Ninth Circuit further erred in declaring the subject franchise agreement arbitration clause "unconscionable" purportedly because it was not reciprocal. In fact, as this Court will note, the subject arbitration clause was completely reciprocal save for three claims which could exclusivity vest in Choice Hotels — indemnification claims against Ticknor (under the franchise agreement, Ticknor could have no indemnification claim against Choice Hotels); enforcement of Choice Hotels' intellectual property rights (Ticknor conferred no corollary rights to Choice Hotels under the subject franchise agreement); and, collection of monies

owed under the franchise agreement (Ticknor could have no such claim against Choice Hotels, as Choice Hotels had no financial obligation whatsoever to him under the franchise agreement). Each and every other claim which petitioner Choice Hotels had against Respondent Ticknor had to be pursued through arbitration, reciprocal to Ticknor's obligation to pursue claims he had against Choice Hotels through arbitration. (Even were this not so, the subject arbitration clause would still not be defective — Montana law actually holds that an arbitration clause vesting discrepant rights in the parties thereto is not, for that reason alone, "unconscionable.")

Indeed, we trust that this Court will note the irony that the case *sub judice* had its genesis in Choice Hotels' commencing just such an arbitration proceeding against Respondent Ticknor.

Simply stated, the Ninth Circuit's determination that the subject franchise agreement's arbitration provision was an unconscionable and unenforceable "contract of adhesion" is antithetical the law of Montana (upon which the Ninth Circuit purportedly relies) and the law of Maryland. What we have here is not the "take it or leave it" parking garage contract-receipt which is wholly one-sided, never read and hardly subject to negotiation. Nor do we confront a setting analogous to that in *Iwen* (the Montana Supreme Court decision relied upon by the Ninth Circuit, as cited and discussed below), in which a consumer had to choose between a "take it or leave it" Yellow Pages listing contract or forego advertising altogether in the only Yellow Pages serving his market area.

No, the setting here is radically different. Respondent Ticknor could have remained independent, but freely chose

to pursue a franchise relationship. Respondent Ticknor had thirty one alternative franchise relationships to select from — he deliberately spurned same in favor of pursuing a franchise relationship with Choice Hotels. As required by law, Respondent Ticknor received full and complete pre-sale disclosure regarding every aspect of the franchise agreement he would have to enter into to become a Choice Hotels franchisee — including the subject arbitration clause at issue herein. As part of that pre-sale disclosure, Respondent Ticknor received a specimen copy of the franchise agreement (containing the subject arbitration clause) for his and his advisors' review. By law, Choice Hotels had to forbid Respondent Ticknor from executing the subject franchise agreement until five business days had elapsed following his receipt of same, further to enable Respondent Ticknor to make a calculated and deliberate contracting decision.[3]

It was only after Respondent Ticknor selected Choice Hotels as the franchise opportunity he wanted to pursue (to the exclusion of thirty one others); after all of the aforementioned disclosure had been effected; after the aforementioned statutorily-imposed "review" period had elapsed; and, after Respondent Ticknor thus had the opportunity to fully comprehend each and every provision of the subject franchise agreement — including its arbitration clause, which was entirely reciprocal save for claims which could vest solely in petitioner Choice Hotels — that Respondent Ticknor put pen to paper and executed the Choice Hotels franchise agreement whose terms he now complains of.

Under such circumstances, the law defeats any suggestion that Respondent Ticknor's franchise agreement

3. FTC Franchise Rule, *infra* at fn.7, § 436.1(g).

was a "contract of adhesion" whose arbitration clause is unenforceable due to purported "unconscionability." Respectfully, the Ninth Circuit erred when it decided otherwise. And unless that decision is reviewed and thereafter reversed by this Court, then the very bedrock upon which franchising rests — franchise network uniformity achieved through franchise agreement uniformity — will be placed in grave peril. So, too, will the Federal Arbitration Act and the Lanham Act.

ARGUMENT

I. A FRANCHISE NETWORK'S FRANCHISE AGREEMENTS ARE *PER FORCE* UNIFORM — BUT, GIVEN THE UNIVERSE OF FRANCHISE ALTERNATIVES AVAILABLE TO A PROSPECTIVE FRANCHISEE, THEY MAY NOT BE DEEMED UNENFORCEABLE "CONTRACTS OF ADHESION"

The lynchpin upon which the Ninth Circuit's decision *sub judice* rests is fundamentally flawed — the holding that the subject Choice Hotels franchise agreement is a "contract of adhesion" since, like virtually all franchise agreements of any given franchise network extant in the United States, it is a uniform contract subject to little (if any) negotiation.

True it is that a franchise network's franchise agreements are virtually always uniform — they have to be. Franchising's bedrock is the public's demand for uniformity. It is that demand which had led to an explosion of franchise activity over the past fifty years, to the point where the U.S. General Accounting Office estimates that today upwards of fifty

percent (50%) of all retail sales in this country — $1 trillion worth — are transacted in franchised outlets.[4]

Franchisors respond to the public's demand for uniformity with uniformity. Indeed, without uniform franchise unit appearance and operations attendant to a network operating under the same name and commercial symbol, the intent and expectation of the Lanham Act, *supra.*, would be contravened. So it is that the Big Mac is prepared identically in the State of Washington as it is in Washington, D.C. Each 7-Eleven store carries virtually the same merchandise as every other. Midas Muffler shops are largely indistinguishable one from another. Each franchised hotel in the Embassy Suites chain operates under the same name; utilizes the same reservation service; and, features guestrooms tailored to the uniform specifications of the franchisor applicable to the size and location of the hotel involved.

It is elementary, but nevertheless true, that a franchise network's uniformity can only be achieved through its use of uniform franchise agreements. These agreements require all franchisees of any given network to conduct business under the same name; build their units in the same way; and, in all aspects of operations, adhere to an identical business format geared to satisfy the public's demand for uniformity. Without such uniform (and frequently nonnegotiable) franchise agreements, the bedrock of franchising would crumble.

But contrary to the Ninth Circuit's flawed analysis, the uniformity and (in many cases) non-negotiability of a

4. GAO-01-776, *Federal Trade Commission Enforcement of the Franchise Rule*, July, 2001 at 5.

network's franchise agreements do not *ipso facto* render them "contracts of adhesion". Because the simple fact is that Respondent Ticknor was not confronted with the type of contract or contractual setting present in the Montana Supreme Court case upon which the Ninth Circuit relies, *Iwen v. U.S. West Direct*, 293 Mont. 512, 977 P.2d 989 (1999). In *Iwen*, as the dissent in the Ninth Circuit's decision *sub judice* observed, the contract at issue was imposed upon a consumer seeking to place an advertisement in the local Yellow Pages, which consumer had to either accept the contract as presented or forego advertising in the only Yellow Pages serving his market area.

However, Respondent Ticknor confronted no such compulsory contractual setting. To the contrary, Ticknor need not have executed a franchise agreement at all; he could have elected to operate his hotel independently, as so many thousands of hotels do. Having elected to pursue a franchise relationship, Respondent Ticknor had a plethora of other hotel franchise opportunities to select from — yet chose Choice Hotels deliberately, even after receiving full disclosure, as required by law (as discussed *infra*.) regarding the Choice Hotel franchise agreement and, in particular, the arbitration clause at issue herein. Indeed, in franchisee Ticknor's guest lodging segment, there were at least thirty (31) distinct guest lodging chains which Respondent Ticknor could have sought to affiliate with but did not, instead freely electing to enter into the subject Choice Hotel franchise agreement which he now contends is adhesive and unconscionable.[5]

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5. These other chains include: AmeriSuites; Holiday Inns; Holiday Inn Express; Best Inns and Suites; Candlewood Suites; Country Inns and Suites; Courtyard by Marriott; Days Inns; Econo Lodges; Embassy Suites; Fairfield Inns by Marriott; Hampton Inns (Cont'd)

In such circumstances, where franchisee Ticknor was in no fashion compelled to enter into a contract at all, and was in no fashion compelled to enter into a contract with Choice Hotels, but instead freely elected to do so while excluding thirty one other franchise opportunities, a franchise network's uniform contract may not be deemed a contract of adhesion simply because of its uniformity. To the contrary, the courts of Maryland and Montana have held that contractual choice actually obviates any finding of adhesion.

For example, the Montana Supreme Court itself has held that when a party having a choice among vendors nevertheless voluntarily elects to enter into an otherwise adhesive contract with one such vendor, no principles of adhesion apply. In *Chor v. Piper, Jaffray & Hopwood, Inc.* 261 Mont. 143, 862 P.2d 26 (1993), a securities brokerage customer commenced a judicial action for alleged brokerage misconduct and, in turn, the brokerage house moved to compel arbitration pursuant to the customer's contract. Rejecting the customer's claim that her brokerage house agreement was a "contract of adhesion" whose arbitration provisions were thus enforceable, the Montana Supreme Court held:

> This claim is not convincing in light of (plaintiff's) deposition testimony. (She) testified that since 1983 she had investment accounts with five other

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(Cont'd)
and Suites; Hawthorne Suites; Hilton Hotels; Homewood Suites; Howard Johnson; Knights Inn; Microtel Inns and Suites; Motel 6; Hampton Inn Suites; Radisson Hotels; Ramada; Red Roof; Residents Inns by Marriott; Rodeway Inns; Super 8 Motels; Townplace Suites by Marriott; Travelodge Hotels; Villager Lodge; Wellesley Inns & Suites; and, Wingate Inns. *Source*: International Franchise Association, *Spring/Summer 2001 Franchise Opportunities Guide*, at 187-193.

> brokerage houses besides Piper, none of which required her to consent to arbitrate future disputes. **She clearly had the ability to go elsewhere if the terms of the agreement with Piper did not suit her.** *Id.* at 150 (emphasis added).

Accordingly, the Montana Supreme Court held that the court below ". . . erred in concluding the (subject) arbitration agreements are void due to unconscionability or because they are contracts of adhesion." *Id. See also* the Montana Supreme Court's 1986 decision in *Passage v. Prudential-Bache Securities, Inc.*, 223 Mont. 60, 727 P.2d 1298 (1986) ("We conclude that even if the customer agreement form is an adhesion contract, there is nothing in the record and no compelling law to prevent enforcement of the arbitration clause").

Should this Court determine to apply Maryland law to the case *sub judice*, the same result will pertain. For Maryland, too, holds that when a party to a contract is not dealing with a sole source supplier of goods and services, but rather has options available to procure the subject good or service from another source, then no "contract of adhesion" argument will pertain. For example, in *Seigneur v. National Fitness Institute, Inc.*, 132 Md. App. 271, 752 A.2d 631 (Md. Ct. of Special Appeals 2000), a health club member injured while exercising complained that the subject health club membership agreement was a contract of adhesion. The contract was uniform, held the court, but it noted that this fact alone did not demonstrate that the defendant health club had grossly disparate bargaining power. The court observed:

> . . . (T)here were numerous other competitors providing the same non-essential services as

> (defendant) NFI . . . To possess a decisive bargaining advantage over a customer, the service offered must usually be deemed essential in nature (citation omitted). The Washington metropolitan area, of which Montgomery County is a part, is home to many exercise and fitness clubs. (Plaintiff) . . . was free to choose among the scores of facilities providing essentially the same services (citation omitted). She also had the option of purchasing her own fitness equipment and exercising at home or of exercising without any equipment by doing aerobic or isometric exercises. (Plaintiff's) bargaining position was not grossly disproportionate to that of (defendant) NFI. *Id.* at 283, 285-286.

Indeed, the Ninth Circuit itself has observed — in a franchise-related decision post-dating that under review — that non-negotiable franchise agreements are not *ipso facto* unenforceable "contracts of adhesion". In reversing the U.S. District Court and directing a franchisee to arbitrate his dispute as his franchise agreement directed, the Ninth Court very recently observed:

> (E)ven if "arbitration agreements are adhesive — i.e., . . . they were offered on a take it or leave it basis with no opportunity for bargaining", under California law, they still may be valid and enforceable, absent evidence that they are so unconscionable, that is, "so one-sided as to shock the conscience" (internal quotation marks omitted).[6]

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6. *Bradley v. Harris Research, Inc.*, 2001 WL 1658728 (9th Cir. 2001) citing and quoting from *Lagataree v. Luce Forward, Hamilton & Scripps LLP*, 74 Cal. App. 4th 1105, 88 Cal. Rptr. 2d 664, 678-79 (1999).

II. THE SUBJECT ARBITRATION CLAUSE WAS NEITHER UNCONSCIONABLE NOR OUTSIDE THE PARTIES' REASONABLE EXPECTATIONS — AND THE NINTH CIRCUIT IGNORED MONTANA LAW IN HOLDING OTHERWISE

The Ninth Circuit, while purportedly seeking to ascertain and follow applicable Montana law, actually ignored that law in the case *sub judice*.

Montana law is clear — and is even quoted correctly in the Ninth Circuit decision *sub judice*:

> To determine the enforceability of a specific contractual provision under *Iwen*, a Montana court must first decide whether the contract is one of adhesion [citation omitted]. If so, then the provision will not be enforced against the weaker contracting party if it is (1) not within that party's reasonable expectations, or (2) if within those expectations, it is unduly oppressive, unconscionable, or against public policy (citing *Iwen v. U.S. West Direct, supra*, and *Passage v. Prudential-Bache, Sec., Inc., supra*.). 265 F.3d at 939.

As set forth below — and as forcefully noted in the Ninth Circuit's dissent in this case — the subject franchise agreement's arbitration clause was indisputedly within Respondent Ticknor's reasonable expectations; not at all unconscionable; and, is utterly distinguishable from that present in the *Iwen* case.

A. The Subject Arbitration Clause Was Indisputedly Within The Parties' Expectations

Respondent Ticknor cannot credibly assert that the arbitration provision at issue herein was not within his "reasonable expectations," and the Ninth Circuit erred by ignoring this second prong of the two prong *Iwen* "unconscionability" test when rendering its decision.

As this Court is well aware, franchising is heavily regulated in the United States by both the federal and state governments. The Federal Trade Commission[7] and fourteen (14) states[8] have laws or regulations on their books requiring

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7. *Federal Trade Commission Trade Regulation Rule:* Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, *16 CFR 436, hereafter the "FTC Franchise Rule."*

8. California: California Franchise Investment Law, California Corporations Code, Div. 5, Parts 1-6, Section 31000 *et. seq.*; Hawaii: Hawaii Franchise Investment Law, Hawaii Rev. Stat., Title 26, Ch. 482E, Section 482-E1 *et seq.*; Illinois: Illinois Franchise Disclosure Act, Illinois Compiled Statutes, Ch. 815, Section 705/1 *et seq.*; Indiana: Indiana Franchise Disclosure Law, Indiana Code, Title 51, Ch. 51-19, Section 51-19.01 *et seq.*; Maryland: Maryland Franchise Registration and Disclosure Law, Ann. Code of Maryland, Business Regulation, Title 14, Section 14-201 *et seq.*; Michigan: Michigan Franchise Investment Law, Michigan Compiled Laws, Ch. 445, Section 445.1501 *et seq.*; Minnesota Franchise Act, Minnesota: Minnesota Statutes, Ch. 80C, Section 80C.01 *et seq.*; New York: New York Franchise Act, New York General Business Law, Art. 33, Section 680 *et seq.*; North Dakota: North Dakota Franchise Investment Law, North Dakota Century Code Ann., Title 51, Ch. 51-19, Section 51-19-01 *et seq.*; Rhode Island: Rhode Island Franchise and Distributorship Investment Regulations Act, (Cont'd)

franchisors to disseminate comprehensive "franchise disclosure documents" (prospectus-type circulars) to prospective franchisees prior to offering or selling any franchise. Under most of the above-referenced state laws, franchisors must register their franchise disclosure documents prior to offering or selling any franchise in the subject franchise-regulating state — as Choice Hotels did in this case.

Critically, this franchise disclosure document must highlight any forum selection or arbitration clause which would limit either litigation or arbitration venue, compel arbitration, or both.[9] Included in each franchise disclosure document must be specimen copies of all franchise and

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General Laws of Rhode Island, Title 19, Ch. 28.1, Section 19-28. 1-1 *et seq.*; South Dakota: South Dakota Franchises for Brand-Name Goods and Services Law, South Dakota Codified Laws, Title 37, Ch. 37-5A, Section 37-5A-1 *et seq.*; Virginia: Virginia Retail Franchising Act, Virginia Code, Title 13.1, Ch. 8, Section 13.1-557 *et seq.*; Washington: Washington Franchise Protection Act, Revised Code of Washington, Title 19, Ch. 19.100, Section 19.100.010 *et seq.*; Wisconsin: Wisconsin Franchise Investment Law, Wisconsin Stats., Ch. 553, Section 553.01 *et seq.*

9. "Guidelines for Preparation of the Uniform Franchise Offering Circular and Related Documents", Item 17 Instructions, Sections "u" and "v", *CCH Business Franchise Guide*, ¶ 5760. The UFOC Guidelines are promulgated and periodically updated by the North American Securities Administrators Association ("NASAA"), whose predecessor created the UFOC disclosure format to eliminate the "patchwork quilt" of confusion engendered by the varying (and sometimes conflicting) disclosure requirements imposed by the fourteen franchise-regulating states. The Federal Trade Commission and each franchise-regulating state has decreed that a franchisor's use of the UFOC document will satisfy that franchisor's disclosure obligations.

franchise-related agreements that a prospective franchisee may or will be asked to enter into.[10]

So it is that Respondent Ticknor was apprised not once, not twice, but three times of the details of the litigation and arbitration provisions present in the Choice franchise agreement: first in Choice's franchise disclosure document (the narrative text of which specifically made reference to same in compliance with the above-referenced "UFOC Guidelines"); second in the specimen franchise agreement which, pursuant to those guidelines, was set forth in Choice's disclosure document; and, third in the actual Choice franchise agreement tendered to franchisee Ticknor for execution.

By law, Choice Hotels had to forbid Respondent Ticknor from executing the subject franchise agreement until five business days had elapsed following receipt of same, further to enable Respondent Ticknor to make a calculated and deliberate contracting decision.[11]

It is thus readily apparent that franchisee Ticknor cannot be heard to complain that the subject franchise agreement's arbitration provisions were not within his "reasonable expectations." It is not at all apparent, however, why the Ninth Circuit chose not to even mention the broad disclosure regarding arbitration, or the regulatorily prescribed "waiting period" which preceded Ticknor's execution of his franchise agreement, when considering whether same was "unconscionable."

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10. *Id.* at ¶5774.

11. FTC Franchise Rule, *supra* at fn.7, §436.1(g).

B. The Subject Arbitration Clause Was Not Unconscionable

Critical to the Ninth Circuit's decision in this case is the conclusion that the subject franchise agreement's arbitration clause was "unconscionable" under Montana law " . . . because it required binding arbitration of the weaker bargaining party's claims, but allowed the stronger bargaining party the opportunity to seek judicial remedies to enforce contractual obligations." 265 F.3d at 940. More specifically, observed the court below, because "(t)he arbitration clause in this case allowed Choice to bring its claims against Ticknor into state or federal court, yet forced Ticknor to submit all claims to binding arbitration as Choice's headquarters in Maryland." *Id.* at 940.

In so holding, the Ninth Circuit erred in many critical respects. To begin with, and as noted in the Ninth Circuit's dissent opinion (*Id.* at 943 and fn.7), the subject arbitration clause did not permit the franchisor to bring all claims against its franchisee in court while relegating its franchisee solely to arbitration. To the contrary, the franchisor's ability to go to court was limited to three instances which had no corollary for the franchisee — to pursue indemnification claims against the franchisee (the franchisor did not indemnify the franchisee, who could thus not pursue any such claim); to enforce the franchisor's trademark rights (again, the franchisee conferred no such rights to the franchisor under the subject franchise agreement); and, to collect monies owed under the franchise agreement (the franchisee could have no such claim against Choice, as Choice owed no monies whatsoever to the franchisee under the franchise agreement).

Each and every other claim which Petitioner Choice had against Respondent Ticknor had to be pursued through

arbitration. Indeed, we trust that it has not escaped this Court's attention that this case emanated from Petitioner Choice's commencement of an arbitration proceeding against Respondent Ticknor.

More critically, the Montana Supreme Court in *Iwen, supra.* — upon which the Ninth Circuit's decision rests almost entirely — actually holds that an arbitration clause vesting discrepant rights in the parties thereto is not automatically "unconscionable." To the contrary, the Montana Supreme Court in *Iwen* held:

> Certainly, this does not mean arbitration agreements must contain mutual promises that give the parties identical rights and obligations, or that the parties must be bound in the exact same manner. This simply restates the rule of law that disparities in the rights of the contracting parties must not be so one-sided and unreasonably favorable to the drafter, as they are in this case, that the agreement becomes unconscionable and oppressive (citation omitted) 293 Mont. 522-23.

Of course, in *Iwen*, the subject arbitration clause was truly "one way" — that is, the purchaser of Yellow Pages advertising thereunder was compelled to arbitrate all disputes, while the Yellow Pages publisher was free to litigate. In the case *sub judice*, as noted immediately above, there is no such disparity of arbitral obligations — only a carveout therefrom conferred upon franchisor Choice to pursue claims that only it could possess.

* * *

Respectfully, the Ninth Circuit committed reversible error by holding the subject Choice franchise agreement's arbitration provision "unconscionable." That arbitration clause was disclosed again and again to Respondent Ticknor by Petitioner Choice; the obligations contained therein were completely reciprocal save for claims that could vest solely in Choice (and never in Respondent Ticknor); and, even after such repeated disclosure regarding the subject arbitration provision, Respondent Ticknor of his own volition determined to pursue a franchise relationship instead of remaining independent; freely elected to execute his Choice franchise agreement; and, deliberately rejected the franchise offerings of fully thirty one (31) other guest lodging franchises available for him to select from.

CONCLUSION

For all of the reasons set forth herein, it is respectfully submitted that the petition for a writ of *certiorari* sought herein by Petitioner Choice Hotels International, Inc. should be granted.

Respectfully submitted,

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In The

Supreme Court of the United States

CHOICE HOTELS INTERNATIONAL, INC.,

Petitioner,

v.

JAMES L. TICKNOR; JANET TICKNOR; LARRY TICKNOR; TICKCO HOLDING, L.L.C.; AND TICKNOR LODGING CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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ARGUMENT

I. THE NINTH CIRCUIT'S FAILURE TO COMPLY WITH THE REQUIREMENTS OF *ERIE* AND *KLAXON* RESULTED FROM ITS FAILURE TO APPLY THE CORRECT RULE OF STATE LAW, NOT FROM A MISINTERPRETATION OF A CORRECTLY STATED RULE OF LAW.

Respondents in their opposition attempt to characterize Choice's argument as one complaining about a determination by the Ninth Circuit that was based upon a "properly stated rule of" Montana law, citing *Meredith v. City of Winter Haven*, 320 U.S. 228, 236 (1943) for the proposition that "[f]ederal courts have a duty to apply state law even where that state law is 'uncertain or difficult to determine.' " Respondents miss completely the point of Choice's argument. Choice's position in this case is not based upon the incorrect application by the lower court of a correctly stated rule of law; rather, Choice seeks review of a judgment that was the result of a failure by the Ninth Circuit to apply Montana law. Contrary to what respondents assert, Montana law does not hold arbitration clauses contained in commercial contracts between sophisticated business entities, as opposed to consumer contracts, to be unconscionable. In *All-States Leasing Company v. Top Hat Lounge, Inc.*, 198 Mont. 1, 6, 649 P.2d 1250, 1253 (1982), the Supreme Court of Montana stated that "[a]lthough courts have readily applied the doctrine of unconscionability to contracts between consumers and skilled businessmen, they are reluctant to rewrite the terms of a contract between businessmen themselves." This is clearly the law relating to unconscionability in Montana as it relates to contracts between

business entities. In ignoring it, the Ninth Circuit disregarded existing state law, and did not merely "misapply" it by reaching an incorrect decision based upon a correctly stated principle of Montana law. In doing so, the lower court disregarded the principles established in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938) and *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487 (1941).

Respondents suggest that the Ninth Circuit "had no opportunity to address" the argument raised by Choice below to the effect that *Iwen v. U.S. West Direct*, 293 Mont. 512, 977 P.2d 989 (1999) did not set forth Montana law with respect to the enforceability of arbitration clauses in contracts between business entities, as opposed to contracts between a business entity and a consumer, because Choice did not specifically cite *All-States Leasing* in its briefs. Contrary to the suggestion by respondents in their opposition, Choice did argue this point in its brief, and the dissenting member of the panel below pointed out the error by the panel majority on this issue. Further, the panel majority showed it was familiar with that case, as it cited the decision in its own opinion and was presumably aware of its holding, and respondents cite no authority for the proposition that, because Choice failed to cite a particular case in its briefs below, the Ninth Circuit was free to disregard the principle of law set forth in that case.

Respondents argue that the Ninth Circuit correctly determined "how the highest court of Montana would decide an issue of state law which was not addressed in existing precedent." Brief in Opposition to Petition, p. 13. As indicated above, however, the lower court specifically disregarded existing precedent from the Montana

Supreme Court indicating a disinclination to apply the doctrine of unconscionability to contracts between businessmen. This was the "properly stated rule of law" that should have been applied by the Ninth Circuit, and its refusal to acknowledge this precedent and to apply it in evaluating the arbitration clause between the parties in the instant case constituted both error and a basis for granting certiorari. *See Leavitt v. Jane L.*, 518 U.S. 137, 144-145 (1996).

With respect to the reliance by the Ninth Circuit on *In re Michael's Estate*, 264 Mont. 261, 871 P.2d 272 (1994), respondents claim that the decision "spelled out the test" for the application of the doctrine of unconscionability in contracts between businessmen; however, even if *In re Michael's Estate* were to be considered the precedent upon which the Ninth Circuit relied in its attempt to "find" state law, it would not support the result in the instant case, for *In re Michael's Estate* merely states that "[o]ppression and a disparity of bargaining power are the indicia of unconscionability relating to a sales contract between two business professionals." Completely absent from that case is any statement that "lack of mutuality of obligation" could somehow constitute a basis for invalidating any contract, much less an arbitration agreement.

Although respondents cite *Spiegel's Estate v. Comm'r*, 335 U.S. 701 (1949) for the proposition that it is the "general policy" of this Court to "leave undisturbed" holdings with respect to state law, that case also establishes that this Court will not only review lower court decisions purporting to apply what is felt to be the law of a particular state, but also that if the decision is wrong, it may be reversed.

II. THE CONFLICTS BETWEEN THE OPINION OF THE NINTH CIRCUIT AND DECISIONS OF THIS COURT, INCLUDING *CASAROTTO*, ARE BOTH SIGNIFICANT AND IRRECONCILABLE.

This Court has held that the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, does not "prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement." *Volt Information Sciences, Inc. v. Board of Investments*, 489 U.S. 468, 478 (1989); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985). Even assuming that *Iwen* correctly states the law relating to contracts involving business entities in a commercial setting, it is clear that a requirement that there be "mutuality of obligation" in an arbitration contract would run directly contrary to that principle. State courts may not, in interpreting arbitration agreements subject to the Federal Arbitration Act, scrutinize such contracts in an attempt to determine whether or not a sufficient number or type of claims may be brought in arbitration by either party to the contract without running afoul of the principles set forth in *Volt* and *Mitsubishi*, nor may a state court attempt to engage in such a practice by engrafting onto existing state law a requirement that there be "mutuality of obligation" in an arbitration contract in order for that contract to survive an unconscionability objection.

With regard to Choice's point that the Ninth Circuit's decision was contrary to the principles of *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), respondents once again suggest that Choice's argument "is simply that there has been a misapplication of a properly stated rule of law." Brief in Opposition to Petition, p. 16. Once

again, however, respondents misstate both Choice's position and the holding of the Ninth Circuit. The lower court specifically relied upon the "mutuality of obligation" language of *Iwen* in invalidating the arbitration clause in the instant case, even going so far as to point out the ways in which it believed that arbitration clause lacked such mutuality. While Choice asserts that the "mutuality of obligation" requirement added onto the law of unconscionability by the court in *Iwen* does not set forth the law with respect to commercial contracts between business entities, and that the Ninth Circuit erred in finding that it did, even if that principle were properly stated and applied, it is a principle that the court in *Iwen* could not have applied solely to arbitration contracts without violating the rule established in *Casarotto*. As demonstrated above, and contrary to the repeated assertion by respondents that the Ninth Circuit opinion relied solely upon the "unconscionability" principles of Montana law, both *Iwen* and the Ninth Circuit went beyond general unconscionability principles under Montana law in their holding invalidating the arbitration clauses in question. As a result, there is a clear conflict between the decision of the Ninth Circuit and *Casarotto*.

III. THE CONFLICT BETWEEN THE NINTH CIRCUIT AND OTHER CIRCUITS CANNOT BE EXPLAINED AWAY OR IGNORED.

In their opposition, respondents submit that there is no conflict between the opinion of the Ninth Circuit in the case below and the decisions of courts in other circuits cited in Choice's petition, arguing that the "Ninth Circuit did not find the arbitration clause at issue to be

unenforceable solely on the basis of a lack of mutuality of obligation. It found it to be unconscionable because it was, *inter alia*, 'unreasonably favorable to the drafter.' " Brief in Opposition to Petition, p. 7. What respondents ignore, however, is that portion of the Ninth Circuit's opinion that indicated what the panel majority believed to be the law on this issue, as set forth in *Iwen*. The following quotation from the Ninth Circuit's opinion, which sets forth its holding, definitively refutes the interpretive gloss respondents wish to place upon that opinion in an attempt to reconcile it with those of other circuits:

> The arbitration clause in this case allowed Choice to bring its claims against Ticknor into state or federal court, yet forced Ticknor to submit all claims to binding arbitration at Choice's headquarters in Maryland. *Iwen* involved an almost identical situation, leaving the Montana Supreme Court to reach the conclusion that the clause was unenforceable. Thus, applying *Iwen*, the arbitration provision in this case "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter."

App. 14; citations omitted. Leaving aside for the moment the issue of whether *Iwen* sets forth the law relating to unconscionability with respect to an arbitration clause entered into between sophisticated business parties, as opposed to what may fairly be characterized as a consumer contract (and Choice contends it does not), it is plain that *Iwen* would only permit an arbitration clause to

be held unconscionable if it "lacks mutuality of obligation, is one-sided, *and* contains terms that are unreasonably favorable to the drafter." (Emphasis supplied.) *Id.* at 977 P.2d 996. App., p. 10. This statement from *Iwen* is clearly phrased in the conjunctive, not in the disjunctive, and requires that all three elements, i.e., lack of mutuality of obligation, one-sidedness, and terms that are unreasonably favorable to the drafter, be present before a finding of unconsionability is made. In light of the foregoing, along with the statement by the panel that the arbitration clause "allowed Choice to bring its claims against Ticknor into state or federal court, yet forced Ticknor to submit all claims to binding arbitration at Choice's headquarters in Maryland," it is clear that the holding by the lower court was based upon an alleged lack of mutuality of obligation; indeed, in the absence of such a finding, it is obvious that the Ninth Circuit would not have been applying the Montana law it found to be expressed in *Iwen* in any event, making its judgment defective for that additional reason. As a result, respondents' characterization of the lower court's opinion is manifestly inaccurate.

The principal basis upon which respondents seek to distinguish the cases cited by Choice as conflicting with the decision of the Ninth Circuit of the case at bar appears to be respondents' perceived distinction between the "mutuality of obligation" concept referred to by the lower court and the concept of "lack of consideration." As indicated in Restatement (Second) of Contracts § 79, however, if "the requirement of consideration is met, there is no additional requirement of . . . (c) 'mutuality of obligation.' " Comment f to that section goes on to state

that the "word 'mutuality,' though often used in connection with the law of contracts, has no definite meaning," and refers to the "confusion caused by treating mutuality as a separate concept" from lack of consideration. *See also, F. Jacobus Transportation Co., Inc. v. Gallagher Brothers Sand & Gravel Corp.*, 161 F. Supp. 507 (S.D.N.Y. 1958) (stating that "the material inquiry in an action at law is not whether there is 'mutuality' but whether there is consideration to support the other party's promise"), citing, *inter alia, Meurer Steel Barrel Co., Inc. v. Martin*, 1 F.2d 687 (3rd Cir. 1924) and 1 Williston, *Contracts* § 105 A (3d ed. 1957). As a result, it is apparent that the statement by the lower court that the arbitration clause "lacks mutuality of obligation" is, in reality, a statement to the effect that there was a want of consideration. Under the circumstances, any distinction of the conflicting decisions in other circuits on such a basis would be inappropriate.

Respondents attempt to generalize the holding of the Ninth Circuit, suggesting that it concerned the "issue of unconscionability," and further suggesting that an "unconscionability analysis is a question of state law." What respondents fail to do, however, is to show that general contract principles relating to the presence, absence or adequacy of consideration would vary from state to state, and that such a variance would account for the differences between the authorities from other circuits cited by Choice and the holding of the court below. As indicated by Choice in its petition, the holding of the Ninth Circuit below was, in fact, at odds with even Montana law, which will not permit the invalidation of a

contract due to a perceived inadequacy of consideration, a principle of general applicability among the states.

In their effort to distinguish the conflicting decisions in other circuits, respondents attempt to cast those decisions, as they did with respect to the Ninth Circuit opinion below, in different terms. For example, respondents assert that the Fourth Circuit in *O'Neil v. Hilton Head Hospital*, 115 F.3d 272 (4th Cir. 1997) "did not even address an argument that the arbitration agreement was unconscionable," though they note that the argument of "lack of consideration" was raised. Respondents ignore the fact that it was the supposed lack of consideration resulting from an alleged want of mutuality of obligation that led the Ninth Circuit to hold that the arbitration clause in the instant case was unconscionable. Respondents also fail to point out that, as with the parties in *O'Neil*, both Choice and respondents were bound by the arbitration clause in question. The lower court did not in any way suggest that Choice could have refused to arbitrate claims brought by respondents or that, having arbitrated them, Choice could have declared itself not to be contractually bound by the result. The court in *Michalski v. Circuit City Stores, Inc.*, 177 F.3d 634, 636 (7th Cir. 1999) also found that the promise of *Circuit City* to be bound by the arbitration process served as "mutual consideration." Once again, in light of the generally accepted modern view of the relationship between the concepts of mutuality of obligation and consideration, it is plain that an argument based upon lack of consideration is not substantively different from one asserting lack of mutuality of obligation.

While respondents assert that the decision in *Kroll v. Doctor's Associates, Inc.*, 3 F.3d 1167, 1170 (7th Cir. 1993) "has nothing in common with the Ninth Circuit opinion," the following characterization by the Seventh Circuit of the contentions of plaintiff in that case belie that assertion: "*Kroll* contends that, even if the arbitration provision is applicable, it lacks mutuality and thus is unenforceable." As is clear from the portion of the decision of the Ninth Circuit quoted above, lack of mutuality of obligation was the reason ultimately given for not enforcing the arbitration clause between the parties. Accordingly, the distinction proffered by respondents is contradicted by a comparison of the very language of *Kroll* and the decision below.

CONCLUSION

In light of the foregoing, petitioner Choice Hotels International, Inc. once again requests that the petition for writ of certiorari be granted.

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